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ABSTRACT

This handbook of economics reviews current economic activities in the United States, encouraging thinking and further study for the reader, rather than providing answers. The book provides a basic framework of knowledge in economics for a better informed citizenry to think clearly and objectively about economic issues in an attempt to combat economic illiteracy which the author considers a basic problem in the United States today. The approach used is to describe the organizations in the economy and to develop economic principles with emphasis on their application and use. Five parts deal with (1) the framework of the economy as it relates to consumers, workers, businessmen, and government employees; (2) prices and markets of the private enterprise system; (3) general view of economic change over a period of years; (4) the relationship of the United States with other countries; and (5) current economic problems of poverty, agriculture, food supplies, inflation, and the energy crises in relation to future economic development. (Author/JP)

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UNDERSTANDING OUR AMERICAN ECONOMY

by

Glen T. Nelson

and

Ray D. Nelson

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PREFACE

Many individuals and organized groups have encouraged our citizens to study how our economy functions. They have tried to promote interest in economic issues by providing a variety of published materials, conducting workshops, and organizing training programs. If the private enterprise system is to function effectively, it is claimed, we must have an informed citizenry. Unless people are aware of economic issues, they cannot be expected to form reasoned judgments about them. Much progress has been made, but economic illiteracy is still considered one of the basic problems in the United States.

The purpose of this book is to review the economic activities in our country so that we can be better informed to think clearly and objectively about economic issues. The approach used is to describe the organizations in our economy and to develop economic principles, but the emphasis is on their application and use. A general survey of the economic happenings is presented to encourage thinking and further study rather than to provide answers.

The book is divided into five parts. Part I describes the framework of our economy as it relates to consumers, workers, businessmen and government employees. Prices and markets in a competitive private enterprise system are explained in Part II. In Part III an overall view is pre-

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sented showing how our economy has performed over a period of years. Our relationship with other countries of the world is analyzed in Part IV. In the last section, some current problems of poverty, agriculture and food supplies for a growing population, inflation, pollution, and the energy crisis are considered as we look to future economic development.

Many people have contributed ideas for this book. The information has been assembled over a period of years in working with leaders of both industrial and educational groups in Illinois, Oregon, and Utah. Others have contributed to the organization and preparation of the materials. Dr. A. Smith Pond suggested the types of information that might be included. Other colleagues at Brigham Young University reviewed the material and made helpful suggestions. The teachers in the inservice training program conducted in Utah and the college students in economics classes read the ideas and made suggestions for improvement. Fred Nelson organized much of the information and illustrated it. Vera Gale, Ellen Johnson, Ann Nelson, and Marsha Jones checked the figures and did the typing. Appreciation is expressed to all those who contributed.

Glen T. Nelson
Ray D. Nelson

June 1974

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PART I

FRAMEWORK OF THE ECONOMY

Chapter 1

OUR CHALLENGE

In a free society many people make decisions each day that influence economic activities. In the United States we take pride in the freedoms we enjoy, but our challenge is to be well-informed citizens in order to make decisions that will help us and those we may influence. How to spend our incomes, where we will work, where we will live and what responsibilities we will take are a few of the decisions we make in our constantly changing society. By our actions, our opinions and our decisions we help shape the future of our economy.

We may have some reservations about the rapid increases in prices. The middleman seems to get more than his share. Some of the laws appear to be unreasonable. A few people are out of work because they did not develop a skill in doing certain types of jobs that are available. We may be concerned about the responsibility society has for those that live in poverty, but it is satisfying to live in a nation where most citizens are willing to work, to save, to invest and to make other contributions to benefit themselves and others.

Fortunately, there is an increased interest in studying our economy that provides opportunities and challenges.

Many would like to understand more about such things as how we measure our progress, how we share what we produce, how prices are determined, the importance of saving and investing to help our country grow, the use of money and credit, the functions of government, our relationship with other countries, and how our economy has performed in comparison with other economic systems.

Some New Attitudes Toward Our Economy

In the late 1940's an economic education program was started with the establishment of the Joint Council on Economic Education. It was founded as a nonprofit organization to coordinate national program and improve economic education. It was governed by a board of trustees representing business, labor, farmers, consumers, and other groups. The Joint Council encouraged the organization of state and regional economic education councils. Programs in many local areas have been financed and supported by groups that believe the best way to perpetuate the American private enterprise system is through an informed citizenry.

Another program to encourage economic education was created in 1960 by the Committee for Economic Development. The CED organized a group composed of five of the nation's outstanding economists and two of its leading secondary

school educators to start the program. The primary purpose of the group was to describe the minimum understandings of economics essential for good citizenship.

Organized programs have been conducted throughout the country. A two-semester economics course has been broadcast on educational TV from coast to coast. Each year more and more school teachers take courses and attend workshops and seminars so they can teach more effectively. Increasing numbers of businesses and labor groups teach economics to their employees. Centers for economic education are being established throughout the country. The American Bankers Association made available grants through the Joint Council to establish new centers for economic education. Economic information is now available through a large number of centers.

Learning about our economy can begin early in life. Teachers are finding a new interest and an ability to understand our economic system. A fifth grade teacher took her class to visit a nearby filling station. Both the youngsters and the owner learned something. After his young visitors learned he cleared about $10,000 a year on a $30,000 investment in land, buildings, and equipment, they started asking questions:

. Did he pay any wages to himself? The answer was no.

How much could he make if he did the same work for

someone else? The man thought about $8,000 a year. "Then the return on your investment was really only $2,000 wasn't it?" asked one of the youngsters. "The balance was really wages you earned."

Another teacher organized her kindergarten classes to learn about money, banking and credit. She wanted them to be able to answer questions such as: What is money? How is it earned? What is profit? Why do we have banks? A local bank agreed to cooperate. The teacher took the students to the bank where all of them signed a promissory note for $10. They took the money to purchase materials and then made candy, cookies and cupcakes. They sold them, paid off the loan plus the interest for a two week period, and used the profits for other projects. The teacher felt this experience made it possible for the five year olds to understand some basic happenings in our economy.

Common Understandings

Many young students as well as older people are learning that there is no other country in the world where everyone has as many opportunities to make decisions as we do in the United States. We recognize the advantages of competition if it does not result in waste and duplication. We are aware of the secret of incentives to progress and growth. We know that ours is a profit but also a loss system. We have the right

to succeed and to fail; but if we fail, we have a chance to try again. We have seen the contribution of tools, specialization, and the advantage of working together. With limited resources we have satisfied many of our wants.

The Need for Straight Thinking

In preserving the right to take an active part in making decisions, we recognize it is possible to be misinformed and that we have a responsibility to think clearly about economic problems. Our economic system is vast and complicated. Nearly ninety million people are at work in our country in over ten million businesses if we include farmers. The economy is constantly changing. Unbiased information that is published can be informative, but we must not be surprised to find certain groups representing their own interests.

One of the problems of sound thinking is the view that economics is a matter of opinion. Differences may arise because a variety of interpretations are placed on facts. Those promoting the view that economics is a matter of opinion may be innocent or they may have a definite objective to persuade the public to support certain political views. Groups on the far right and far left often attempt to persuade the public without sound economic foundation.

Most people are not particularly concerned about the views you hold on theories of chemistry of physics, or how well you like Shakespeare. Economic ideas, however, affect

the pocketbook. Economic policies that will increase your income, cut your taxes, or provide you with more services automatically have a strong appeal. You have definite opinions if the decisions affect you. An innocent but far from harmless source of bias is the tendency to assume that other people are in one's own position. It is hard, for example, for watchmakers to understand why anybody should object to restricting the imports of Swiss watches.

The question might be raised, "Do consumers buy the best produce available?" Surveys show that the average consumer could increase his satisfaction and spend less to do it if he would study consumer guides. Too many people, it is pointed out, buy on impulse, particularly with large purchases. A potential home owner often makes a decision on the basis of one feature rather than a careful analysis of the home as a unit.

If we consider that individual interests may differ from those of society and that part of the truth may give us the wrong impression, we will probably be in a better position to think straight about our system. We do not always have to agree with each other. Different ideas have challenged us through time and accounted for much of our progress.

How One Thinks About Economic Problems

Economics is a social science. We study activities devoted to providing a living. We try to satisfy our wants with the resources we have available to us. We study the production and consumption of goods and services. The sale of what has been produced yields income to those who have contributed in one way or another to its production. All processes necessary in getting goods into the hands of users are productive. Somebody must finance the process and assume risks until the ultimate user pays for the goods he buys. Raw materials must be shipped to factories and finished goods must be transported to where they are needed. Wholesalers and retailers assemble and store goods in convenient quantities until the consumer is ready to buy them.

These activities deal with farmers, workers, households, and business concerns. The present day economic system is characterized by specialization which permits each person and each region to use to the best advantage different skills and resources. Specialization lends itself to mechanization and the use of labor-saving capital to increase production.

While some men would work for the joy of accomplishment or the sense of prestige their work provides, most production is a result of desire for income or financial return. The

workers must be paid a wage. Those who finance the purchase of tools must be paid interest. The owners of natural resources must be paid for the materials or services they offer for sale as well as for the costs and risks they have assumed in discovering and extracting the resources. The owner of the business, in return for his planning and his risks, hopes for profits.

The consumer is the ultimate source of all payments. Businessmen will not produce unless they think they can sell. They cannot sell unless somebody will buy. People will not buy unless they have the desire and purchasing power. Their buying power depends on their income. Desire is created by actual need and for effective marketing through advertising and salesmanship to increase the amounts purchased that are necessary to efficient production. To do all this, every society needs an economic system. We have not always agreed nor do we now agree on what is the best system. Over a period of years we have been influenced by great economic thinkers. Their ideas have helped us to think more clearly about economic problems.

One of the first of these men was Adam Smith of the University of Glasgow. In his famous book Wealth of Nations, written in 1776, he described the British economy and the economic revolution with specialization of labor and increased

productivity. To him it was a wonderful world of opportunity.

As the industrial revolution developed with its resulting problems in the early 1800's, writers such as Thomas Malthus and David Ricardo in Britain were concerned about the future. It was a gloomy world to them. Malthus wrote An Essay on the Principles of Population as It Affects the Future Improvement of Society. His basic premise was that population would increase so fast that enough food could not be produced for them. David Ricardo saw the problem as a conflict between landlords and nearly everyone else. Society to Adam Smith was a great family, but to Ricardo it was a bitter contest for supremacy. It is understandable how economics in this period could be labeled as a dismal science.

In studying economic history, it is easy to understand why men like Malthus and Ricardo were concerned about future strife and gloom. Their ideas, however, were not shared by some then or now. A group known as the Utopian Socialists were interested in replacing the capitalistic-oriented society. Robert Owen was an example, but his temporary success soon gave way to failure and lack of support by any administrative group.

When Karl Marx wrote his Communist Manifesto in 1848, there was another view on the future of capitalism. He left little doubt concerning the future of the working class and their relationship to the "ruling class." He openly

declared that the workers must forcibly overthrow the people who were taking advantage of them. His book was really a collaboration of his ideas with those of Friedrich Engels.

In 1890 Alfred Marshall wrote his book, Principles of Economics. This was the most comprehensive and complete treatment of economics to that time. Marshall was considered one of the main contributors to economic thought in his time and is recognized by contemporary economists for his balanced analysis of economic problems.

History seems to repeat itself again when Thorstein Veblen wrote his Theory of the Leisure Class in 1899. He presented a challenging analysis of social conduct that pointed out the problems he described as the misuse of wealth. All through the book he emphasized the waste and undesirable consequences of our modern idea of "keeping up with the Joneses." The attitudes of people and their uneconomic decisions were real problems to Veblen. Some thought he was a socialist in his thinking. In another book he published in 1904, The Theory of Business Enterprise, he recognized the businessman as the central figure but no longer the motivating force in society. He believed that the days of the business leaders were numbered.

John Maynard Keynes from England, considered by many as the most influential economist in the present century, was well educated and successful financially at an early age. He wrote several books, but the most important one was

The General Theory of Employment, Interest and Money, published in 1936. The emphasis was on studying the whole economy rather than individual businesses or single industries. When he visited the United States in 1934, it was obvious that our problem was lack of sufficient current investment in buildings and equipment on the part of business. He claimed government should spend when business faltered. Keynes did not see government programs as a permanent interference with the course of business, but a helping hand. Much has been written to interpret Keynes. His approach and method of analysis opened up a whole area of study to challenge economic thought. When we study the whole economy and think about economic problems in our modern society, the ideas of Keynes are now a part of our thinking.

In our modern society, many writers have presented ideas to challenge our thinking. Adolph Berle and Gardiner Means in their book The Modern Corporation and Private Property warn us about large business. Friedrich Hayek attacked government planning in The Road to Serfdom. J. Kenneth Galbraith wrote a best seller, The Affluent Society, questioning the ability of the consumer to make wise decisions and challenging different groups in society. These are only a few who have contributed to modern day thought concerned with our economic system.

Our Capitalist-Oriented Society

We have an economy that is often referred to as a mixed market capitalistic-oriented system. The rise and development of the market system has taken place over a period of years. Before people did much trading, there were business units, but their purpose was to preserve an orderly way of life rather than to make money. Charging interest and making profits were looked down on. The ideas of an expanding economy and using large business units were not a part of the economic thinking.

With the use of money and wealth being recognized as a political, military, and religious power, the market system began to develop. Urbanization, merchant trading centers, the Crusades and the change in the religious attitude of allowing gain all contributed to freer trade. Labor was a commodity for sale. Land was bought, sold, and leased. Rent was considered a return for putting the land into profitable use. Interest was a return for the use of money. Competition was prevalent, but in many cases was harsh and unjust, particularly for individuals. Society as a whole, however, was experiencing a drive for economic development. These changes set the stage for the industrial revolution with the tremendous impact of technology and progress, but not without problems such as poor working conditions, monopoly control and idle facilities of business.

Our economic system was not originally patterned after any particular model of another country. It developed, undergoing changes as consumers, producers and governments made decisions.

Our system and the success we have had can be explained to a large extent with four characteristics: (1) private enterprise which offers the individual the right to engage in any business activity providing he can obtain the necessary capital and can get a license where it is required, (2) competition to encourage business to satisfy customers and adopt efficient methods, (3) profit motive, which is one of the key incentives for taking risks and assuming ownership responsibilities. Other incentives are personal advancement, public service, and security, (4) a price system that allows for adjustments through the market system where private enterprise, competition, and the profit motive can work effectively.

Ideally it is a system that is based primarily upon individual freedom. Sellers usually cannot charge much more than the minimum costs at which a product can be produced. In most cases the land, labor, and capital will be used where it is most productive. Buyers will try to use their incomes in ways that will give them the greatest satisfaction.

Every economic system is concerned with the basic problem of satisfying the wants of the people with the resources that are available. Individually we are concerned with working, earning, buying, saving, and investing. We are interested in

better education, improving our living standards and making plans for the future.

We spend our income for the things we most desire. In doing this we help decide what is produced. The businessman may try to influence us to buy his products, but we really vote for the things we want produced by the way we spend our incomes.

As producers, we decide on the methods we use after considering the alternatives. Which method is most efficient? What combination of land, labor, and capital will give the results we desire? How much profit is necessary to encourage people to invest in our business, or what return do we need to provide the incentive to continue producing? These are questions that are important to all businessmen, and we shall consider them as we study our system.

Even in a market system there are some necessary laws for controlling the production of such things as guns or harmful drugs. The government, by taxation, reduces our power to spend or to invest, so it in some ways influences consumption and production. But in our economy there is no single force or central authority that has a dominant influence. In most cases balance of power among businesses, labor groups and government organizations makes ours a mixed rather than a true market system. Let's look at some of these different organizations.

A single picture of our economic organizations is difficult to describe. Agriculture is considered a private enterprise industry, but we have used acreage controls, marketing quotas, government purchases, price supports, and school lunch programs that influence market prices.

The large corporation is a complex organization. It is a legal person in the eyes of the law, and it must be approved by the government because it has to be issued a charter to do business. The corporation pools the investment of many persons. It is operated by professional management and supervised by a board of directors that usually does not hold a majority of the stock. It may be accused of charging excess prices, fixing prices, and taking advantage of competitors and consumers. Business size may be confused with monopoly, but most corporations actively compete with other large corporations.

Even though the small businessman has become less important in the proportion of total business done in our economy, he still performs many services and competes in the retailing industries. The opportunity to start a small business is a valued freedom.

Labor organizations as representatives of workers are a significant part of our economy. It is claimed that labor organizations become large because businesses are large. Labor leaders work actively on organized programs. The future

of labor unions will depend basically on the positive policies they follow in relation not only to businesses but to government activities.

The government sector of the economy is becoming increasingly important. The activities of the local, state, and federal governments are interrelated. Some basic questions of responsibility are constantly being considered.

The frame-work of our economy with over 200 million consumers, hundreds of businesses, large labor organizations and governments at the local, state, and federal levels provides a basis for understanding the importance of each group. In the next three chapters, we shall consider in more detail the role of each of these groups in our economy.

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Chapter 2

THE CONSUMER AND PERSONAL FINANCIAL DECISION

Every citizen in his activities each day helps to determine the future of our country. Economic life revolves around consumers. As individuals we are usually more expert as producers than as consumers. We know how to do our work efficiently, but researchers conclude we can be better informed as consumers. They claim that a better understanding of budgeting, spending, installment buying, insurance, housing needs and investing can contribute to making better decisions.

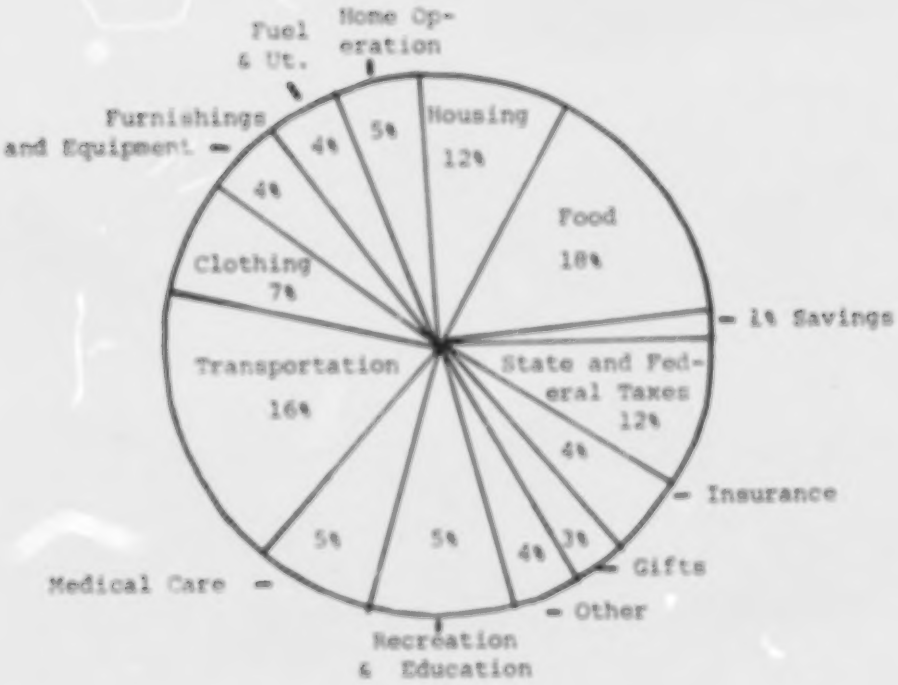
The Family Budget

Budgeting can be an aid to economizing if we have difficulty balancing our budget. For the family that needs to budget, a list of the things they plan to buy is usually made for a given period of time. But since their income is limited, the decisions must be made as to what should be purchased first after the basic necessities are satisfied. Decisions must be made on whether to buy a new car now or make the old one do and save for a son's education if both cannot be done. Maybe the decision is between a new car or a down payment on a home.

General guides are useful for everyday decisions. The

U.S. Department of Agriculture publishes "A Guide to Budgeting for the Young Couple." In this publication, it shows how the income dollar might be spent to have a balanced financial program.

F A M I L Y B U D G E T D O L L A R



The expenditures for the young couple will change as the family grows and as income increases. Average family buying patterns are changing, and will probably do so in the future. In 1972 an average family of four spent its income as follows:

	1972
Food including meals out	23.1
Housing and household operations	24.0
Clothing and personal care	10.9
Transportation	8.8
Medical care	5.6
Recreation and education	6.2
Income tax	12.5
Insurance	3.8
Other expenses	5.1
	100.0

Source: McCalls, February, 1973

Budgeting can help the family to live within its income, eliminate some waste spending, and achieve long-range goals. It provides an education for the parents as well as the children in the management of money. Parents who let the children help make financial decisions find it is easier for the young people to make decisions on their own later.

Spending Guides

Wise spending is the next step in managing our income. Is price a good indication of value? Is there a definite relationship between quality and price? From the consumer's point of view, the matter of quality is always relative to the uses to which a product is to be put. So the questions are hard to answer. We do have some guides as to why we make certain decisions.

We may be willing to pay extra for something especially attractive because we enjoy it or because we desire to impress others. These purchases often cost more than they are worth. On the other hand, it is often poor economy to buy an article merely because it is cheap. Inferior materials carelessly put together may give poor service and be quite costly in the long run. Many of us are aware too that identical goods can often be purchased at different prices.

Price, then is not necessarily a reliable index of quality. We need to know standards of comparison. The Pure Food and Drug Act requires labeling of product contents and protects consumers from harmful foods and drugs. The Federal Government has set up standards for many foods. Two well-known private national organizations engage in testing commodities and making known the results. The organizations are Consumers' Research and Consumers' Union and their publications can be found in most libraries, if individuals do not subscribe to them.

The United States' Departments of Labor, Commerce, and Agriculture as well as state groups and local municipalities also makes available large amounts of information to help consumers. Bulletins of these groups on topics such as food, shopping, cooking, health, clothing, recreation, and family finances are available at a nominal cost.

Other groups such as the Household Finance Corporation put out a series of publications on money management. Separate pamphlets are distributed on your food dollar, your clothing dollar, your shopping dollar, your automobile dollar, your saving and investment dollar, and your budget dollar. "Changing Times: The Kiplinger Service for Families," publishes a Family Finance Diary in addition to the regular magazines. National Consumer Finance Corporation has a Slide Guide--"Divided Responsibility Family Budget Plan." This slide rule type of publication shows how family income is divided among our various expenditures for food, home operation, clothing, shelter, transportation, and other expenses.

Consumer Decisions

Advertising programs influence many of our decisions. We are aware that we have to make decisions on the use of credit, how to invest our savings, how much we shall pay for a home, and what to consider in buying life insurance. We usually make better decisions if we use consumer information and considered the alternatives.

Advertising--Help and Hinderance

Advertising is a form of product differentiation that attempts to develop in the minds of buyers that the product or the service of one seller differs from those of other sellers.

Quality differences may be real or imaginary, but in both cases they influence many consumers.

There are some arguments in favor of advertising:

1. It can make the consumer a more competent purchaser and provide him with better products.

2. It is convenient for shoppers because it provides visual aids in buying.

3. It helps raise the consumer's standard of living by creating mass markets, and therefore, lower prices.

4. It promotes honest, fair deals because nothing would hurt the reputation of an industry like the use of exaggerated or questionable claims.

But some advertising is misleading. Large economy size packages sometimes cost more per unit than smaller packages. "Cents off deals" are the result of starting out with a higher price than is normally charged, and the consumer may pay an even higher price. Offering to sell a 10-ounce rather than a 12-ounce package of a product when the potential customer is not aware of the size is another advertising gimmick. The package is the "salesman" in today's market.

Several individuals and groups, including the Federal Government, have shown concern about misleading advertising. Truth in Packaging and Truth in Lending bills have been approved by Congress. Many producers have gone to great effort to make labels informative. Consumers' Union and Consumers' Research organizations conduct tests and print materials to rate products on quality and performance. Trade associations,

professional groups, and better business bureaus are also helpful in publishing information to guide the consumer.

There are arguments for and against the value of advertising to the economy as a whole. It is claimed that sales are increased by advertising. Because of a larger volume of business, there is greater efficiency. Is it possible that total sales are not increased, but advertising merely encourages consumers to buy from another seller? What about the large amounts of money spent and the duplication of advertising efforts on the part of so many competitors? Do the costs outweigh the benefits? Evidently most companies think advertising pays as evidenced by the amount of money spent and the variety of methods used over a period of time.

Business organizations that use advertising have guides to help them make decisions. Can the product be differentiated from its potential substitutes? Is there an expanding market for the product? Can the promotional efforts be coordinated with other selling activities? Positive answers to these questions serve as a basis for successful advertising.

Trading Stamps

The use of trading stamps is an important part of the food industry to influence consumers. Most chain stores and many independent operations use them to build and hold consumer loyalty. The use of trading stamps is considered a way to increase business enough to cover the costs of the stamps

and increase the profits.

Do trading stamps raise food prices? Research studies show that you ordinarily do not get something for nothing when you get trading stamps. Individual stores may have to increase prices. Prices are estimated to be increased by about 2 percent. Advertising no longer stresses merchandise values but rather stresses stamps. Who then gets the benefit? We are told there are possible advantages in increased sales, improved margins and a more even distribution of volume throughout the week for the retailer, but in most cases, the consumers pay higher prices. The real advantage then appears to be to the stamp companies to avoid price competition. The case for and against trading stamps has developed into a problem with lack of objective information and failure on the part of special interest groups to properly represent other interests.

Cash or Credit

Another decision we must make is whether to pay cash or to use a charge account. The trend has been toward buying more on credit, but there are advantages of both cash and the proper use of credit.

Advantages of Cash Payments	Advantages of Credit
1. Cash payments do not restrict the shopper to	1. A good credit rating comes in handy in emergencies.

stores where he has a charge account. A person can therefore do a better job of shopping.

2. Stores that do not have a high billing and collecting expense have lower prices.
3. Discounts are sometimes given for cash payments.
4. Cash payments do not permit consumers to overbuy.
5. The consumer usually knows where he stands on his budget.
6. A person feels good to be free of debt.

2. Credit is convenient to the consumer, who does not need to carry money or checkbook.
3. Ofttimes good and faithful customers of one store get better service.
4. The consumer is not limited to the cash he has at the moment.
5. Credit involves a pay-as-you-use plan, but control over spending is needed.
6. Use of credit makes possible increased production for the whole economy.

There are good arguments on both sides. It is up to the consumer to weigh each side and decide which is the best for him. Intelligent use of credit can greatly increase one's personal level of living. The poor use of credit has just the opposite effect.

With easy credit, personal debt has increased to the point that it has caused concern to policy makers. Have we gone too far in allowing so much credit? Is borrowing for consumption different from borrowing for production? Why shouldn't a company borrow money at 6 percent interest if it can make an 8 percent return, but isn't this different from borrowing for a new automobile when the old one is satisfactory? Borrowing for consumption is different from borrowing for pro-

duction, and companies expand on the basis of borrowed capital which creates jobs, provides earnings, and results in growth.

Many feel that borrowers are deceived into paying excessive interest rates simply because they don't know what they are actually paying. A handy table to use in figuring the interest rate we actually pay when the total amount is repaid in twelve equal monthly payments is as follows:

When they say	We pay
4 percent a year	7.4 percent
6 percent a year	11.1 percent
8 percent a year	14.8 percent
10 percent a year	18.5 percent
1 percent a month	22.2 percent

If credit is charged only on the unpaid balance:

When they say	We pay
1 percent a month	12 percent
1.5 percent a month	18 percent
3 percent a month	36 percent

Source: Consumer Report, 1967

To figure the true rate of interest we can use the following formula:

$$100 \times \frac{\text{Total Amount of Interest Paid}}{\text{Average Monthly Balance Due}} = \text{True Rate of Interest}$$

The Truth in Lending Bill was passed by Congress to protect consumers. Presumably the arguments both for and against installment buying were considered. Some of them seem reasonable. Others could be questioned:

Advantages	Disadvantages
1. The family is able to use goods while they are paying for them.	1. It reduces a person's buying power and eventually lowers his standard of living.
2. It contributes to raising the standard of living.	2. It tempts a person to overbuy.
3. It increases the national prosperity by additional consumer spending.	3. It sacrifices a person's margin of safety for emergencies.
4. Some people claim it teaches the value of thrift.	4. It may discourage thrift.
5. It allows people to get a start in life.	5. It creates worries and tensions.

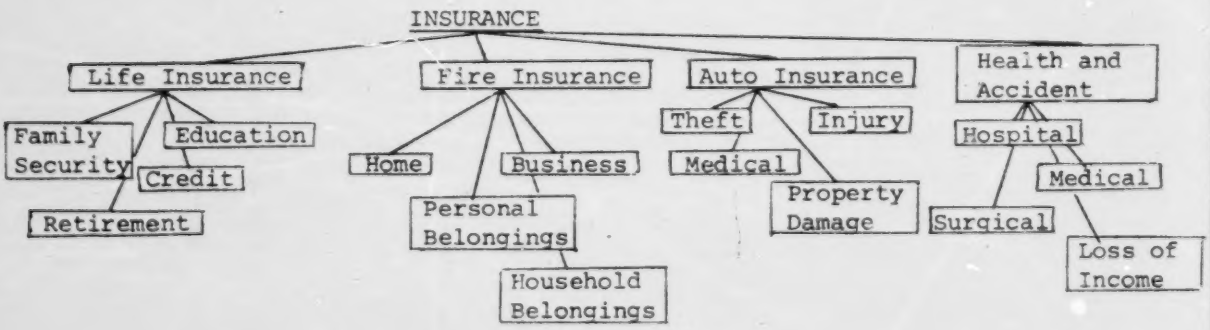
Planning for the Future

Each period of life has its own problems. During the early years of family responsibilities when incomes are usually low, protection of the family with insurance, especially for the father is important. Preparing for possible years of reduced employment of retirement is vital in making those years pleasant ones. Financial preparation through an organized investment program can be accompanied by psychological and emotional preparation. Learning to live economically may be justified not because we have to, but because it is a good way of life.

Financial advisors emphasize the importance of protecting the family. Insurance in an amount up to five times your annual income is often suggested for adequate protection if you do not have investments to protect the family income. An emergency fund, depending on the requirements of the family, is recommended. An amount equal to three months pay put in a savings account, a credit union, or some other place where it can be secured quickly is sufficient for the average family. After the basic requirements including adequate family housing are met, a regular savings program rounds out the financial planning for the family. Methods used to plan for the future are considered separately.

Insurance

An insurance program is considered essential for families that do not have investments which provide sufficient income to support their dependents. Even then, fire, auto, health, and accident insurance are important for personal security. The following is a diagram of the types of insurance:



Insurance does not remove risks. It merely enables individuals to pool their financial resources and share the financial impact of such losses. If 1,000 automobile owners grouped together to pay insurance and in the next five years the losses plus administration charges were $200,000, each owner would have to contribute $200 for the insurance. This is an example of pooling resources to share the risk.

In planning an insurance program, a knowledge of the different types of insurance is important. Reputable insurance agents can describe alternative policies. Usually the agent will show the possibilities of government programs such as G.I. Insurance and Social Security along with the policies he sells.

Social Security - And Other Security Programs

Fortunately, an adequate retirement program is not as hard to get today as it was years ago. Social Security, company pension plans, and investment programs are available to workers. Most retirement programs are built around the government Social Security.

In 1935 Congress passed the Federal Social Security Act. This Act provided welfare and health services. Changes have been made over a period of time to give greater coverage, more realistic rates, and a better balanced program. The three basic programs now used are Old Age, Survivors, and

Disability Insurance; Unemployment Compensation; and the Medicare Program.

Old Age, Survivors, and Disability Insurance. The Old Age, Survivors and Disability Insurance program was enacted to help those who (1) reach retirement age without providing adequate means of support, (2) do not make provisions for the financial security of their dependents in the event of their early death, and (3) do not make provisions for their financial security in case they should become totally disabled before their retirement. This insurance provides compulsory protection to every citizen and involves a broad area of coverage.

When Social Security was set up in 1935, it was intended that the revenue collected would cover the costs of the program. From 1937 to 1949 the tax rate was 1 percent for the first $3,000 of a person's yearly income. It has gradually increased to 5.85 percent on $10,800 in 1973. The maximum paid by the worker as a result of these changes was increased to $631.80. The following table shows the tax rates and amounts paid since 1937.

FEDERAL SOCIAL SECURITY TAXES

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Years	Social Security O.A.S.D.I.	Tax Rate Medicare	Total	Covered Wages	Maximum Tax Paid By		
					Employee	Employer	Self-Employed
1937-49	1.%	--	1.0%	$ 3,000	$ 30.00	$ 30.00	$ 45.00
1951	1.5	--	1.5	3,600	54.00	54.00	81.00
1955	2.0	--	2.0	4,200	84.00	84.00	126.00
1959	2.25	--	2.25	4,800	120.00	120.00	180.00
1962	3.125	--	3.125	4,800	150.00	150.00	225.00
1965	3.625	--	3.625	4,800	174.00	174.00	261.00
1966	3.85	.35%	4.2	6,600	277.20	277.20	415.80
1967	3.8	.6	4.4	6,600	290.40	290.40	422.40
1968	3.8	.6	4.4	7,800	343.20	343.20	499.20
1969	4.2	.6	4.8	7,800	374.40	374.40	538.20
1970	4.8	.6	5.4	7,800	374.40	374.40	585.00
1971	4.8	.6	5.4	7,800	465.60	465.60	585.00
1972	5.25	.6	5.85	9,000	468.00	468.00	675.00
1973	5.25	.6	5.85	10,800	631.80	631.80	864.00
1974	4.95	.9	5.85	13,200	772.20	772.20	1,042.80

Source: Social Security Administration, Provo, Utah.

Unemployment Compensation. While Old Age and Survivors Insurance is administered by the Federal Government, unemployment insurance is operated by the states with some assistance and supervision by the Federal Government. Every State in the union has an unemployment compensation program.

The Federal Government began in 1935 by levying a 3 percent tax on payrolls on annual earnings up to $3,000 per employee against all employers in commerce and industry who had eight or more workers for twenty or more weeks of the year. The law now provides for a 3.28 percent change on $4,200.

Each state has set up its own program. Generally the person receiving benefits must have been employed a specified time in the covered business. He must not have been discharged for misconduct, have quit without good cause, or be out on strike. He must register for work at a public employment office and be willing and able to accept suitable employment. Benefit payments are limited to prescribed periods and the amounts vary among the states.

Most of us have heard comments on the success of this program. In many cases individuals have tried to take advantage of the situation to collect the compensation rather than work. Some have resented taking any job not exactly comparable to the one in which they were previously employed. It appears, however, that most of those obtaining unemployment are not abusing the privilege.

A large proportion of the payments are made during periods of recession. The spending of the payments tend to act as an automatic stabilizer to the economy. When people are out of work, they have at least the unemployment compen-

sation to spend which helps ease the downward movement of our economy. The stabilizing effect is considered a favorable part of the program.

The Medicare Program. In July, 1965, the Federal Government established the broad program of health insurance for the aged. Because of the new medicare program, the Social Security tax rate was boosted from 3.8 percent to 4.2 percent. The present rate is 5.85 percent. Of the 5.85 percent, 4.95 is for the Old Age and Survivors Insurance and 0.9 percent is for the new medicare program.

Medicare benefits do not apply until one reaches 65 years of age. The Social Security Amendments of 1965 provide two different kinds of health care for those people 65 or older. Hospital insurance will pay most of the cost of hospital services and certain other post-hospital expenses. Medical insurance will help pay for part of the cost of doctors' services and certain other medical expenses. All persons 65 or over are automatically entitled to hospital insurance, but medical insurance must be applied for, and there is a charge of $3.00 a month. All medical and hospital costs are paid by having a certain percentage paid by government and a certain percentage paid by the individual. Also, medical insurance involves a $50 deductible in which the patient pays the first $50 of each calendar year and then 20 percent of remaining costs. The government pays the other 80 percent.

Our Housing Needs

An attractive and comfortable home is usually high on the priority list in the plans for most families. For the average young couple, it means finding a suitable apartment or house to rent. When a family can finance the buying of a home, then the decision is whether to continue to rent or to buy a home. Financial advisors usually recommend that if we expect to move soon, if prices are declining, or we do not have enough money for a substantial down payment (20 to 25 percent of the purchase price) then it may be best to continue to rent. On the other hand, if we are established in a growing community, prices are reasonably stable, we have enough money for the down payment, and the price less the down payment does not exceed 2 to 2 1/2 times our annual income, buying a home is a desirable goal. Those who encourage us to purchase a home say it provides security, encourages savings, and gives us a sense of civic responsibility.

Selecting a home is an important financial decision. Family needs now and in the future, the neighborhood, the utilities available, the conveniences or location of schools, churches, shopping centers, and recreational areas should be checked. The cost of the lot in relation to the house, the amount of taxes, the interest rate and the closing costs are a few other things to consider.

Interest rates and the time period of repayment are

especially important in making decisions concerning the purchase of a home. Below are examples of how total interest cost is affected by the length of a mortgage and by interest rates.

TOTAL INTEREST COST PER $20,000 OF MORTGAGE

Interest Rate	10 years	20 years	30 years
7 1/2%	$ 8,512	$18,688	$30,400
8%	9,136	20,176	32,848
8 1/2%	9,760	21,644	35,296

From the preceding figures it is obvious that the amounts paid out in interest especially at the higher rates over long periods of time are higher than the value of the mortgage. Thus a home buyer who can afford it can do much to offset high interest rates by paying off his mortgage in the shortest period possible after making as large a down payment as he can manage.

On the other hand, it can be argued that the interest payments are deductible as an expense in computing personal income taxes, and the home can be sold easier if it has a mortgage a potential buyer can take over. Borrowing as much as you can on the purchase of a home can be justified if it appears that property values will increase, that inflation will continue and that alternative investments will be attractive.

There has been some concern among people buying and selling property of the high closing costs. Such terms as finders fee, survey, credit report, appraisal fee, often are not clearly understood. On a $20,000 loan, closing costs to the borrower are often over $500. We can benefit as buyers of property if we ask for an explanation of these costs if they are not understood, since some of the costs may not be necessary from a particular buyer's point of view.

Investing

Investing in business and sharing in the progress of the American economy is similar to buying land, purchasing a home or buying a small business. We agree to loan money to a business organization. We are a creditor, and we receive a bond as security or we buy stocks and become a part owner. If a person owns 100 shares of stock in International Toys, he is part owner of the company. When International Toys makes a profit, part of the earnings are paid back to the stockholders as dividends.

Bonds are usually the most stable of all securities, since interest is paid regardless of whether the company makes a profit or not. Bondholders are creditors of a company, not owners. If we are interested in stocks, and do not have enough money to buy 100 shares of International Toys Company, then we can buy in odd lots (less than 100 shares). For all stocks

listed on the exchange, we buy or sell through brokers. These brokers often suggest when starting to invest that we put the money in several companies, but not so many that we will not have time to analyze them periodically. They usually recommend that we make decisions in buying stocks or bonds on the basis of possible growth and returns on investments over a period of at least five years. Dividends for common stock are usually paid every three months. The commission charges for the broker's service in both buying and selling are ordinarily based on the price of the stock and the volume traded. In most cases competition rates are now used.

When and what stock should we buy? Obviously this question is not easy to answer, even for the professionals. Selecting a stock or a bond is an important decision. How good is the company's management? How popular are its products? What about the competition, and the company's relationship to the whole industry? Brokers will provide information and help in making investment decisions.

To protect investors the Securities and Exchange Commission is a government agency set up to regulate the trading of securities in the United States. Foreign brokers sometimes try to sell securities through the mail. The S.E.C. cannot regulate these, but they can provide information as to whether the broker is reputable or not. Individual states have laws to encourage fair business dealings with or-

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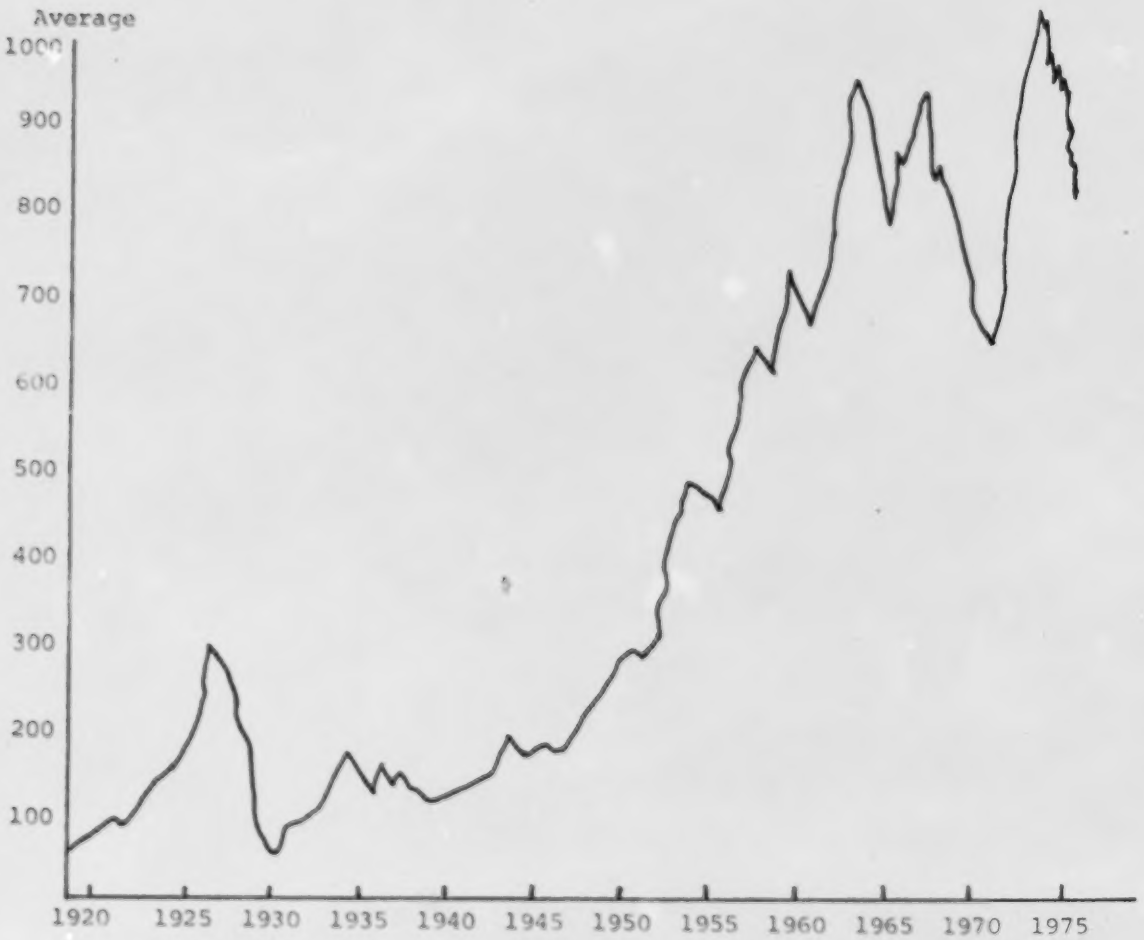
ganizations that sell securities and those that buy them.

It is interesting to follow trends in the stock market. The market does not always go up, but the overall trend the past several years has been rising. We measure the progress of the stock market using various averages or indexes. One of the most common is the Dow Jones Industrial Average. Thirty prominent companies are used to show the progress of the market. The value of one share of stock for the 30 companies considering the adjustments such as stock splitting are



Source: Survey of Current Business, United States Department of Commerce.

quoted periodically each day as the buying and selling takes place. For example, when the Dow Jones is quoted at the end of the day as 850 in comparison to the close of yesterday at 845, it means that the market has moved up 5 points. We can trace the progress of the market in the chart on page 39.

The stock market plays an important role in the American Economy. It is a means of putting new capital back into the economy for growth and a device to transfer the ownership of stocks and bonds. There are many investment opportunities in the American economy in comparison to those in other countries.

Other Investment Opportunities. We may not want to be bothered with making decisions on which stocks or bonds to buy. Professional groups will do this for us. We can still be a creditor or an owner. A popular way is to invest in a mutual fund that has purchased stock in a wide variety of companies. The financial managers decide when and which stocks to buy and sell. The earnings of the mutual fund are allocated to the stockholders after expenses are deducted. If we are interested in letting others use our savings, such organizations as credit unions, savings and loan associations, savings accounts in banks and government bonds provide varying degrees of security and growth possibilities.

An investment in education is one that appears to give a high return. Vocational and college training provide the

basis for a greater productive individual. Skilled people can find jobs more easily than the unskilled. Several studies have been made to show the high financial returns on money invested in education. One of these studies will be analyzed in Chapter 6.

Opportunities for a good formal education are not available to everyone in the United States, but every citizen in his activities each day has an influence in determining our future in the United States. There is an increasing amount of information being published to help us make better decisions. By using this information, we can evaluate trends, events, and policies, as well as anticipate their outcome.

Chapter 3

BUSINESS AND LABOR ORGANIZATION

The organization structure of any country is an important factor contributing to its success. In our country business and labor groups, in general, have served us in providing a large amount and a good variety of goods and services. There is some concern that businessmen have too much influence or that their profits are too large. The activities of some labor organizations have been questioned. Regardless of our attitudes, we usually recognize that each group has an influence in our society and that a balance of power has advantages if we are to maintain a good mixture for growth and development.

Business Organizations

Each business must have some type of organization before it begins operation. Business organizations can be privately owned. Farms and small stores are generally operated by individual ownership. Others are set up as partnerships where combined labor, capital, and other resources may make them more efficient. Lawyers, real estate men, and others often form partnerships. A chain store or a filling station may be owned by a corporation to allow many people to own part of the

business and share in its success. Ownership in the form of stock may be purchased and sold freely. Large amounts of money are available to have specialization and efficiencies of size. A fourth type of business is the cooperative. Farmers often market their products, purchase supplies, and provide other types of goods and services through a nonprofit cooperative where the success is shared by the members.

What Business Does for Us

Business provides us with more goods and services than are enjoyed by those in any other country. This remarkable abundance is a result of the long historic development of business through our desire to invest and work hard. It is true that our scientists and inventors have made major contributions. Using the techniques of specialization, productive businesses reduced the cost of each unit produced. This has made more and more goods available to larger numbers of people in lower income groups.

Sometimes it is pointed out that our way of doing business fails to achieve perfect adjustment between production and consumption. This leads to excesses, large inventories, and lower prices or reduced supplies and higher prices.

Some Controls Are Necessary

It is important in each of these business organizations to provide an environment so they will be encouraged to produce

high-quality products at a reasonable price. Profits are essential and provide the incentive in a private enterprise economy, but if left uncontrolled business organizations often take advantage of different groups. Some monopoly groups have not been interested in using our resources to satisfy the wants of the public. We shall consider some specific cases in Chapter 8.

Management's Role--A Common Case

A problem that constantly confronts management is how to produce the most efficient way to meet competition and increase productivity in our specialized economy. All of us have the opportunity to become owners of our own business. We would have to have a form of organization just the same as an economy must be organized. One alternative is a single owner who organized the resources, assumes the risks and takes all the profits. You might want partners to provide more capital and get the benefit of more ideas. If the business gets large, you may want to incorporate and sell stock. There are many possibilities which we shall consider in an example.

Let's look at the case of an ambitious young man we shall call Mr. Seymour. He has ideas. He is not afraid to work. He is willing to take a chance. He has confidence in the government and the country in which he lives.

Mr. Seymour works for Benjamin Furniture, a small store, as the purchaser and handler of their stock. He likes his work because he gets satisfaction out of helping his customers. He always does his best to get quality furniture and his customers know this.

One thing bothers him. It seems that the finish on the wooden chairs and tables he has been selling wears out when any liquid soap or detergent is applied. The shiny finishes are reduced to a dull gloss. Mr. Seymour thinks of how he might help reduce the number of complaints. He has tried buying different furniture, but this has failed. There are no hard table finishes on the market.

But, Mr. Seymour has a hobby. For two years he has been working in his garage on a new invention. He has developed a process of sanding and finishing furniture that applies a new hard seal to the wax. He has tried it out on his furniture at home and the finish remains shiny and clear. He let his neighbors try it. They, too, were pleased with the results.

As a successful salesman and being encouraged with the new process he has developed, Mr. Seymour is interested in owning and operating a store. He has saved some money. He analyzes the community needs and potential markets for furniture. He knows of a small building that is for sale in a good location. His banker thinks the possibilities for success are good. His lawyer sees no problems. His wife

is enthusiastic about beginning a business. He is aware of the competition and the problems of operating a business of his own. He still has a reservation about his biggest competitor. Two blocks away is Sanfords Furniture Co. Shoppers that come to the city see the big sign, "Sanfords: Top Values, Wholesale Prices." He also considers the records that must be kept, the long hours to work and the sacrifices that will be involved, but he decides it is worth a chance to organize Enterprise Furniture.

Enterprise Furniture, because of its favorable location, new furniture-finishing process, and friendly service, grows more rapidly than anticipated. Mr. Seymour likes being his own boss, and he finds he is making more money than he did when he was a salesman. Even though he is busy, he does take time to get information about the furniture market. He tries to sense the public needs and consumers' wants. He advertises in the papers and on the radio emphasizing his new "Hard Seal Product."

Mr. Seymour now has another challenge. His sales have expanded and he now has orders for his Hard Seal Furniture from other cities. His furniture is definitely superior to anything on the market, but his competitors are making more of an effort to get more of the market. Mr. Seymour feels that if he does not expand, some big company using mass producing methods and having a large research staff to develop new

products may take the potential market he has developed. He doesn't have the money to build a new building. He can't continue to keep the records, do the buying and take care of the selling. He needs help. He decides to visit his lawyer.

After Mr. Seymour tells his story to his lawyer, it is decided that the best form of business organization for Enterprise Furniture is a partnership. A neighbor helped him set up his bookkeeping system. He has been interested in the progress of Mr. Seymour's business. He mentioned he had saved some money as a result of his good job at the steel company as an accountant. The lawyer said he had a friend in a nearby city who had experience in the furniture business and was interested in working for himself. He had been a traveling salesman for a long time where he had contacted large supply companies. He was tired of a traveling job. But it paid well, so he was able to save some money to invest. A partnership seemed to be the best answer when the three finally got together with the lawyer and talked over their interests.

The decision to organize a partnership was finalized only after consideration was given to liability, how the earnings were to be divided and the responsibilities of each of the partners. All three knew that each was liable for the decisions of the others even to the extent of their personal property. There could be difficulty in transferring ownership unless all partners agreed. Disagreements could occur over how the business should be run. With more capital, however, Enterprise

Furniture could be remodeled. The store in the other city could handle the same products and economies could be had in buying carloads of furniture. Combining of skills and judgment of the three of them could provide for greater managerial ability. The advantages seemed to outweigh the disadvantages.

As the partnership had anticipated, the business grew rapidly. Mr. Seymour was the senior partner since he had more money invested in the organization, but he gradually gave more authority to his partners. They had talked some of buying two other stores. They had considered remodeling the existing store. Business was good, so they decided to go ahead. The banker had agreed to provide the money they needed for building. All went well until the partner in charge of buying went on an extended trip and negotiated several long-term contracts to supply a variety of furniture for the anticipated expansion of business. He had not cleared with the partner in charge of finance or with Mr. Seymour. They had over-committed themselves. Each partner was liable for the decision, but Mr. Seymour was especially con erned.

Mr. Seymour's first comments to his lawyer after he explained what had happened were, "See what you got me into. I would have been better off as an individual owner." The lawyer in turn suggested that the skills and money of his partner might have contributed to the success of the organization.

Mr. Seymour was quick to agree. He had enjoyed his partners. They were fine men, but he emphasized again this did not solve the problem. "Yes," said the lawyer, "but what you really want is to have some way so you won't have liability for the decisions of your partners. The partnership up to now has done well. You have grown fast. Maybe the best type of organization for you now is a corporation."

"Yes," Mr. Seymour agreed, "the liability is the problem, but to incorporate means red tape, reports, and government regulations. Federal and state taxes are high and I will have little to say about the operation if we sell stock and have a board of directors to make the decisions. What are the advantages of incorporating?"

The lawyer responded by emphasizing the limited liability of stockholders. "Liability is only for the money invested, not for your home, car, or property as it is with the partnership. Corporations have continuous existence and do not end with the death of one person. Greater amounts of capital can be obtained by selling stocks to interested people. Ownership is easily transferred with stocks. You, Mr. Seymour, can still maintain control if you wish by limiting the stock that is sold, since you will have the most money invested in the organization. You will be the chairman of the board of directors by right of your voting stock. Since you need money to fill your contracts and the bankers have agreed to support your expansion program, I will buy the extra stock if you decide to incorporate. I think Enterprise Furniture has a bright future."

Our example illustrates that different forms of business organizations have their advantages and disadvantages. The type will depend on the needs. Large corporations have some of the advantages and disadvantages as do the smaller corporations. It is a matter of degree. Some can even get so large that they are not as efficient as smaller ones. In each case, the role of management and the combination of land, labor, and capital are important.

We have also seen the different methods of financing. The owner's money with what he can borrow from the bank or other financial institution is common for an individual proprietorship. Additional money might be obtained if a partnership is formed. With the corporation there are a few additional alternatives. Stocks can be sold to those who wish to become part owners. There are two general types of stocks: common and preferred. Common stock represents the assets not represented in obligations to others. Earnings not needed to pay the claims of others go to common stockholders. One advantage of stock ownership is the right to vote, although in some cases preferred stockholders are granted the voting privilege.

The claims of the preferred stock against the earnings of a company come ahead of those of common stock. There are several kinds of preferences as to earnings depending upon the policies of the company. Since the voting privilege is

seldom given to preferred stock, this is of little concern to most small investors. The millions of stockholders leave the impression that voting, especially by proxy, is not very important. There is a growing tendency for corporations to appeal to the individual stockholders to support their organization as a customer as well as an informed and loyal part owner.

When a corporation sells stock, it does not become indebted to its stockholders because they are its owners. Bonds, however, are evidences of debt. The bondholder is a creditor. He must be paid interest regularly and upon maturity of the bond, his original loan must be returned to him. In the case of failure of either, he can sue the corporation. Many investors prefer bonds because of the safety of the investment. Even though bonds tend to be more secure than stocks, they vary widely in the degree of security with different organizations. One of the serious limitations of a bond is that the income is stable but in some cases of serious difficulties it may go down. The failure of the income of the bond to keep up with rising prices is also a problem, but it may be offset by advantages of bonds when prices are falling.

The Role of a Cooperative

A fourth type of organization is a cooperative. It is a special form of a corporation that is chartered by the state

similar to the regular corporation, but is designed to provide services for its members such as buying or selling goods. The purpose of a cooperative is not to earn profits, but to provide efficient cost savings in different services. A group of farmers, for example, can join together to market their goods to obtain a better price instead of selling individually and competing with each other. There are many kinds of cooperatives in our country. They involve not only agriculture, but credit unions, health care programs, rural electric programs, and consumer stores. A true cooperative is a nonprofit organization. It is usually financed by its members, but does at times handle its finances similar to other corporations.

Cooperatives distribute all their earnings to the members on the basis of the volume of business they have had with the organization during a certain period. Each member has one vote no matter how much money he has invested, so cooperatives claim they have democratic control. The cooperative in our society is and has been a sound organization for selected groups. They have not been without their problems of member support, inadequate financing, poorly trained leadership, and inadequate public relations programs. These problems, however, are associated with individual businesses as is true with any other business organizations.

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Labor Organizations

As long as tools were simple, many workers owned the equipment they used, and those that worked for others were closely associated with their employers. Frequently the employee was an apprentice, learning the trade and expecting someday to become the employer.

During the nineteenth century new inventions led to the development of expensive machinery. The concentration of machinery in large factories generally destroyed the old system of small, widely scattered industries. The old relations between employers and employees were also changed. The number of employees per employer increased from one or two to hundreds and thousands. Personal contact with each employee became impossible in the modern corporation. There were other problems such as long hours, low wages, and unpleasant working conditions during the early years of the industrial revolution. Children often worked twelve to fifteen hours a day in factories and mines. Working conditions were often difficult. In attempting to improve his lot, the industrial worker was at a disadvantage.

Early Difficulties in Organizing

To strengthen his bargaining position, the worker attempted to organize with his fellows, but in so doing he ran into legal difficulties. While the common law permitted men to form free

associations, it prohibited their conspiring against others; so their actions, when they attempted to organize, were held to be conspiracies and hence illegal. The laws were eventually changed and unions were recognized.

The Structure of American Unions

The union member's contract is with his local union. He pays his dues to the local union and has a chance to elect the officials. In most cases, the local union will conduct negotiations with employers concerning wages and working conditions, will sign agreements, and will represent the union members in presenting grievances or other problems of the workers to the employer.

Local unions, if they belong to a larger group (national union), elect delegates to go to periodic conventions where policies are determined and national officers are elected. National unions often set general standards governing the policies of local unions. They require payment of part of the membership dues. In turn, the national union provides information, represents local unions on national issues, and in general supports local labor programs.

Many national unions have joined the large American Federation of Labor and the Congress of Industrial Organization (AFL-CIO). Many feel this organization is too large and has too much power. Some question whether the workers are really

represented by the locals. Only a small percentage of the local members, on the other hand, attend meetings and participate actively in local union decisions. It should be emphasized that labor organizations do not represent all the workers. Only about one-fourth of the labor force belongs to unions. Most of the non-union workers, however, are protected by legislation prescribing maximum hours and minimum wages.

Government and Unions

Like business organizations, labor unions need laws and regulations for standard operating procedures. These regulations were provided for in the Wagner Act of 1935. To enforce its provisions, the Act set up the National Labor Relations Board (NLRB).

Unions experienced tremendous growth under the rulings of the National Labor Relations Board and the stimulus of economic activity of World War II. Labor scarcities strengthened the bargaining positions of labor and excellent profit conditions intensified the demands of employers for the services of labor. With these developments, legislators passed the Taft-Hartley Act and later the Labor-Management Report and Disclosure (Landrum Griffith) Act.

The Taft-Hartley Act of 1947 declared certain union practices to be unfair and illegal. For example, Section 14b permitted states to have right-to-work laws. These laws have been bitterly

debated in many states and national groups. They are based on the right of each worker to be free to choose whether or not to join a union. Unions condemn them since they weaken the power of the unions.

The Landrum Griffth Act was passed in 1959 to require among other things filing of union financial reports, limiting union loans to officials to $2,000, and prohibiting non-wage payments by employers to union representatives. The Act also provides rights for union members which guard against rigged elections and summary disciplining of members of the union. Although denounced by unions, the Taft-Hartley and Landrum Griffith Acts are regarded by many as introducing a better balance to union-management relations.

Labor-Management Relations

The first main issue for which unions fought was the right to exist. Even after they had become well established, employers often refused to bargain with them. It is generally accepted now that collective bargaining is an established method both in our social attitudes and in the law.

Collective bargaining gives workers, through their unions, a voice in determining the affairs of their working lives, including rules for promotions, layoff and discharge of workers. They help decide on fringe benefits such as pension plans, vacations and health insurance. Collective bargaining, however, with large unions and powerful employers often results in

delayed decisions and misunderstandings. Both sides in labor disputes have at times resorted to violent tactics. Employers have on occasion locked out their men, discriminated against union men, and even brought in outsiders to break up strikes. Unions have accompanied some of their strikes with coercion against strikebreakers who were keeping factories running. At times property of the employer has been severly damaged and strong measures have been taken to divert customers from him.

Both union leaders and employers need to understand the basic principles upon which cooperative human relations are built. We have begun to realize that each side needs to recognize the problems and viewpoints of the other side and to acknowledge that each has definite responsibilities to the other. The job of bringing out such mutual responsibility is far from complete. It is human nature to regard our own problems and interests as more important than those of the other person.

Labor Disputes

We hear very little about the normal negotiations between unions and employers which are settled without serious dispute. Actually most contracts are settled without much difficulty. When strikes occur, the public interest is usually involved. A strike in one industry may shut down plants in other

industries depending on the use of raw materials or the markets. Supplies of food or other items important to consumers may be threatened. Transportation tie-ups may prevent thousands from going about their normal business. The social consequences of large strikes may be very serious.

When threatening crises have developed, pressures for government to do something about the problem have multiplied. Often an impartial outsider is authorized by labor and management to hold a hearing concerning the dispute. Both parties may agree in advance to accept his decision. In other cases when labor and management are unwilling to call in arbitrators they are compelled to get together. Such is the case in a national emergency. There are times when each group is investigated and required to do certain things. The Taft-Hartley Act provides that when in the opinion of the President of the United States a strike threatens to imperil the national health or safety, a board of inquiry may be appointed to investigate the dispute. If the report of the board warrants, an injunction against striking for sixty days may be issued by a court. If the dispute is not settled within that time, the board reports to the President about the current situation. Within the next fifteen days a secret ballot of the employees must be taken on the employer's last offer. If the dispute is still not settled, the President is required to submit to Congress a comprehensive report of the findings.

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If in the opinion of the President the situation requires action, the Government can seize the business. This does not mean that the affected properties are taken out of private operation and ownership. It is a strike-blocking formality. The President of the United States at different times has seized the railroads, the coal mines and the steel mills to compel the continuance of operation. Labor complied with a Presidential order and called off strikes on the railroads. Leaders of the coal mines defied the order and large fines were assessed against the mine union and union officials. In the case of the steel mills, the Supreme Court held the seizure to be illegal use of power. All of these are interesting cases for those who would like to study them in more detail.

Chapter 4

GOVERNMENT AND OUR ECONOMY

Our history provides some evidence that a market system especially without an appropriate framework can be ineffective. Instability, failure to maintain full employment, growth of monopoly and departure from competition are a few of the problems. These unsatisfactory developments do not mean that replacement of the market mechanism with government controls will always produce better results. There is a need for a continuing search for proper combinations of market arrangements and government policies.

Government influence in our economy is increasing. About one-fifth of total spending is done by local, state, or federal government groups. Think of the extra things we could buy if we didn't have to pay so much in taxes, and where are the benefits? Are we financing representatives in government who really live it up at our expense?

How many times have you heard statements like these? Just how much of a role does the government play in our lives? What should we expect of government? What does it do for us? Where does the government get its money? How does it spend it? To answer these questions in our own minds, we should have an informed opinion about the duties, responsibilities, and processes of government.

General Functions of Government

If one general function of government doing for the people what they cannot do for themselves? Someone must take the responsibility of defending our nation against aggressors. Providing law and order in our cities is important too. Construction of water mains, sewers, sidewalks, recreational and educational facilities seems to be done more efficiently if the city officials coordinate the activities rather than for each property owner to put in his own sidewalks that may or may not be the same as his neighbors'. The government acts as a referee through such groups as the Food and Drug Administration, Interstate Commerce Commission, state regulating groups and city inspection organizations. Because government provides law and order, protects persons and property, and uses a system of courts for orderly settlement of disputes, an environment is created in which the individual has the freedom to enjoy the fruits of his labors.

Another function that is becoming more important which government can do effectively is the gathering and publishing of information. Such groups as the Departments of Commerce, Labor, and Agriculture make information available to individuals and groups to aid them in everyday decisions.

Over a period of years we have had wide fluctuations in prices. More recently the use of automatic stabilizers such as the unemployment compensation, social security and the

graduated income tax have helped to even out the business cycle. The stabilization function of government was emphasized when the Employment Act of 1946 was passed by Congress and the President was given authority to use every means available to him to provide a stable economy. Other programs to help the poverty stricken, provide for better housing, and encourage welfare programs have been put into operation. Governments have assumed an important role in economic life.

Government and the Individual

Government regulates our activities by such measures as setting minimum wages for different industries, limiting the work day and week, restricting the labor of minors, licensing many types of businesses and enterprises, and limiting the different uses of property by zoning ordinances. The government has other programs to help groups and individuals. The Urban Renewal Administration designates money to pay the cost of slum clearance and redevelopment programs. Government groups, federal, state, and local grant loans and make funds available for the construction and maintenance of low-rent public housing. The Federal Housing Administration insures mortgages of homes. Because of this insurance, lending agencies are more willing to lend large amounts of money for home purchases, for the risk of loss is reduced. This program has enabled many people who

would otherwise not have enough money for a down payment to buy a home of their own.

Many Americans believe that government should supply only those services and benefits for the consumer that cannot be supplied as effectively by private enterprise, but it is not clear where the functions begin and end. Some cities have public transportation supplied by government, while other cities supply transportation by private enterprise. Water is supplied by private companies in some cases and in others by government.

Government and Business

Government both encourages and controls economic progress by initiating and enforcing laws that regulate business practice. For example, laws that govern contracts are necessary in the free enterprise system. When a T.V. set is delivered to a consumer in return for his promise to pay, the consumer must pay. When a piece of equipment is delivered to a producer in return for his promise to pay, the producer must pay under law. The buyers know that if they do not pay, the sellers can take them to court, where the law will be administered.

Business is regulated by government for different enterprises such as utilities and railroads. Anti-trust laws that control monopoly and food inspection regulations are examples of other regulations. In case of war or emergency, the government has used special controls on business in controlling pro-

duction, wages, and prices.

Government plays a big role in agriculture. Government partially pays for goods or services that it thinks should be produced in a different way or in greater abundance. It does this by subsidizing or giving special financial assistance to different industries and products. The government influences farm prices by buying certain commodities and then storing or disposing of a large enough quantity to keep prices at a certain level.

One of the most debated issues of our time is the continuing expansion of government in business. It is difficult to know whether we pay more or less by paying taxes for a service provided by private enterprise. Examples of government in business are the St. Lawrence Seaway and the Tennessee Valley Authority. Private enterprise may have difficulty in competing with government business because government does not have to pay taxes and it is a nonprofit-making organization.

Government as a Business

One must remember that government is our biggest spender today. It spends at least one-fourth of our total national income, and one in every eight persons is in governmental service. Government acts as a producer through research in atomic energy and other productive activities, but it has been far more active

as a consumer in purchasing goods and services. Federal, state, and local governments purchase goods and services that amount to about 20 percent of the value of all that is produced.

What Does the Tax Dollar Do For You?

Few of us realize how much the tax dollar does for us. We take for granted the services provided by government, because we do not receive the services at the same time we pay our taxes. Taxes are actually the price we pay for protection and freedom.

Let us consider the family of Albert and Helen Barton. They are a young couple just married and starting out in life. What government functions play a part in their life?

Albert was born and reared in the city. His father died about five years before he and Helen were married. Before he died, Albert's father had drawn a government check each month to supplement his job because of disability suffered in World War II. Besides having saved some money, Albert's parents owned their home. Therefore, Albert does not need to worry about making enough to support his mother because she has her home and receives Social Security to supplement her small income.

Helen was reared in the farm country of the Midwest. Her parents owned a dairy herd and a small poultry setup. The government had helped them by providing information to show how to obtain the best yields by improved practices. The services of the county agent and 4-H Club programs were other aids.

Albert and Helen honeymooned at Yellowstone National Park. Everywhere they looked the government was involved: highways and bridges, national parks and forests, weather reports, conservation programs, dams and reservoirs built by government, postal service, and laws for protection of food.

This young couple established a home in Colorado. Albert obtained a G.I. loan because he served in the Korean War. Water, lights, gas and sewage disposal were available in the community where they decided to live. Fire departments, hospitals, parks, museums, libraries, and public schools were also provided by the city. This example illustrates some of the things our government does for us. Here is a list of some of the other benefits we receive from our government:

1. Defense of our country.
2. Provides agencies for settling labor disputes.
3. Regulates communication industries.
4. Inspects banks and controls credit.
5. Supports colleges and universities dependent on federal aid.
6. Provides and regulates money and currency.
7. Controls fluctuations in business prosperity.
8. Maintains prisons for law breakers.
9. Protects certain industries from competition for foreign products.
10. Controls false advertising.

Our Taxing System

For governments to be able to spend, they must obtain the funds. The most important source of funds is taxation. Government owned enterprises, fines, license fees, and gifts also provide income.

The power of government to tax is usually not questioned, but the method of acquiring the revenue is often discussed. It is important to a nation and its people that the taxing system be economically and ethically sound. It should exercise the least harmful influence on production. If taxes are too high, the incentive to produce may be reduced. The costs of collecting the taxes certainly must be less than the revenue collected. These sound principles are more easily determined than when we try to decide the basis on which payments will be made.

The principle that individually we should pay for what we get from the government is hard to administer. This would mean that a family with six children would pay twice as much as one with three children in financing public education. But how do you determine who pays for national defense? To charge everyone the same amount would be difficult. The family with a low income cannot pay as much as would be required of them. We do, however, use this principle with gasoline taxes to share the costs of highway construction. City streets are paid for from gasoline taxes and special assessments based on the benefit principle.

It is generally felt today that most of our taxes should be levied in accordance with the ability to pay. Our system of taxation is a compromise method, but largely in accordance with our ability to pay. Our federal income tax is a progressive tax, taking a larger percentage of income from higher income groups. The higher the income, the higher the tax rate. In contrast we have a regressive tax. The sales tax as an example takes proportionately more income from lower income groups because they spend a higher percentage of their income for taxed goods and services. A few of the important features of the main taxes we pay are of interest to most people.

Individual Income Taxes. The individual income tax is the largest source of revenue for the federal government. It is also used by several states. This tax is levied as a percentage of individual income after certain allowable deductions. The federal government allows us to use exemptions for dependents, gifts to religious, charitable, educational, and scientific organizations, for taxes paid such as the property tax, for interest on borrowed money and for a selected list of miscellaneous expenses.

Corporation Income Tax. The next most important source of revenue of the federal government is the corporation income tax. This tax, like the individual income tax, is progressive above the small income groups. The rate rises as corporation profits increase. Business expenses such as costs for labor and

materials, interest paid, and depreciation are allowable deductions.

Sales Taxes. The sales tax is levied on retail sales. This tax has grown in importance as a source of revenue. In some cases state and local government share the sales taxes collected.

Property Taxes. Earlier in the history of our country, the property tax on real estate was the most important source of revenue. It is still important for local governments. Some criticize the local reliance on property tax, since ownership of property is not related to the ability to pay. The ability to pay, they argue is more related to personal income. The increase in home ownership, however, somewhat reduces this objection. In many communities where they depend on the property tax with increases in local expenditures, the size of tax levies is a real burden. The burden depends not only upon the rate that is being charged, but also on the assessed valuation.

The Federal Budget

Since there are wide differences among states and local governments in the methods used to finance their operations, only the federal budget will be considered. The federal budget covers a period from July 1 to June 30 of the following year and is designated by the calendar year in which it ends. The budget submitted to Congress the first part of the year goes

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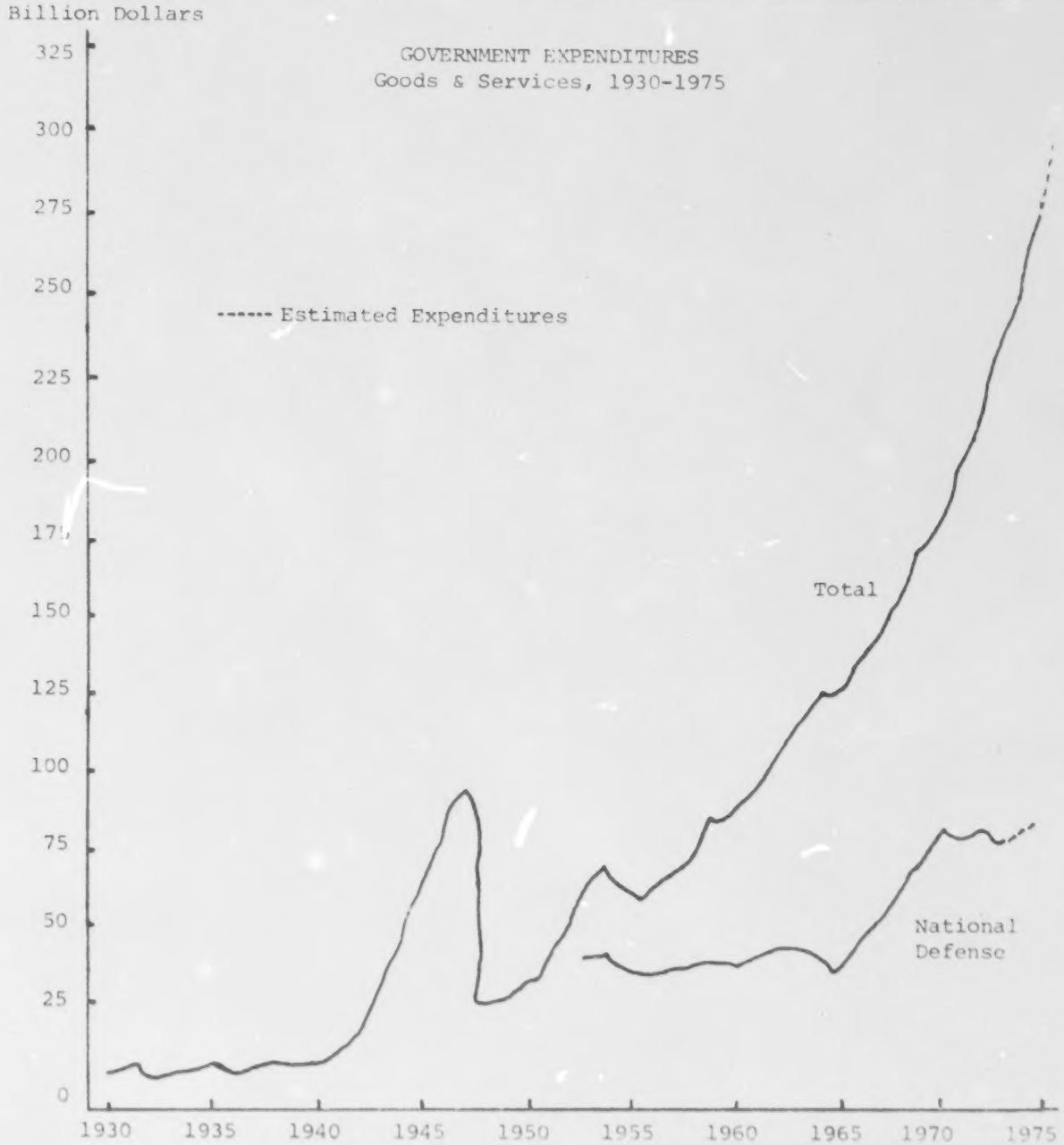
into effect July 1 and continues to June 30. The budget information is publisned in most newspapers and in business magazines as well as in the Economic Report of the President to



Source: Economic Report of the President, 1974.

Congress at the beginning of each calendar year.

Over a period of years, individual income and corporation income taxes have accounted for four-fifths of the receipts. State and local governments, in contrast, depend to a large extent on property and sales taxes for their revenue.

If expenditures for national defense and veteran's programs are added together, we find that costs of wars and preparation for the defense of our country account for a large proportion of the total expenditures. We could add the interest on the debt too, since the largest increases in debt have been in war periods. The importance of national defense as an expenditure is shown in the chart on page 70.

Over the last forty years, the government has had both surpluses and deficits in spending. In most years, receipts were not large enough to take care of spending, so the government borrowed the rest of the amount. The relationship between expenditures and receipts is shown in the chart on page 72.

Some people are concerned about increased taxes. They argue that individuals and corporations will not have an incentive to increase their incomes if government is going to take in taxes much of these additional earnings.

Other people maintain that we should not be alarmed about current government spending. Much of the money spent

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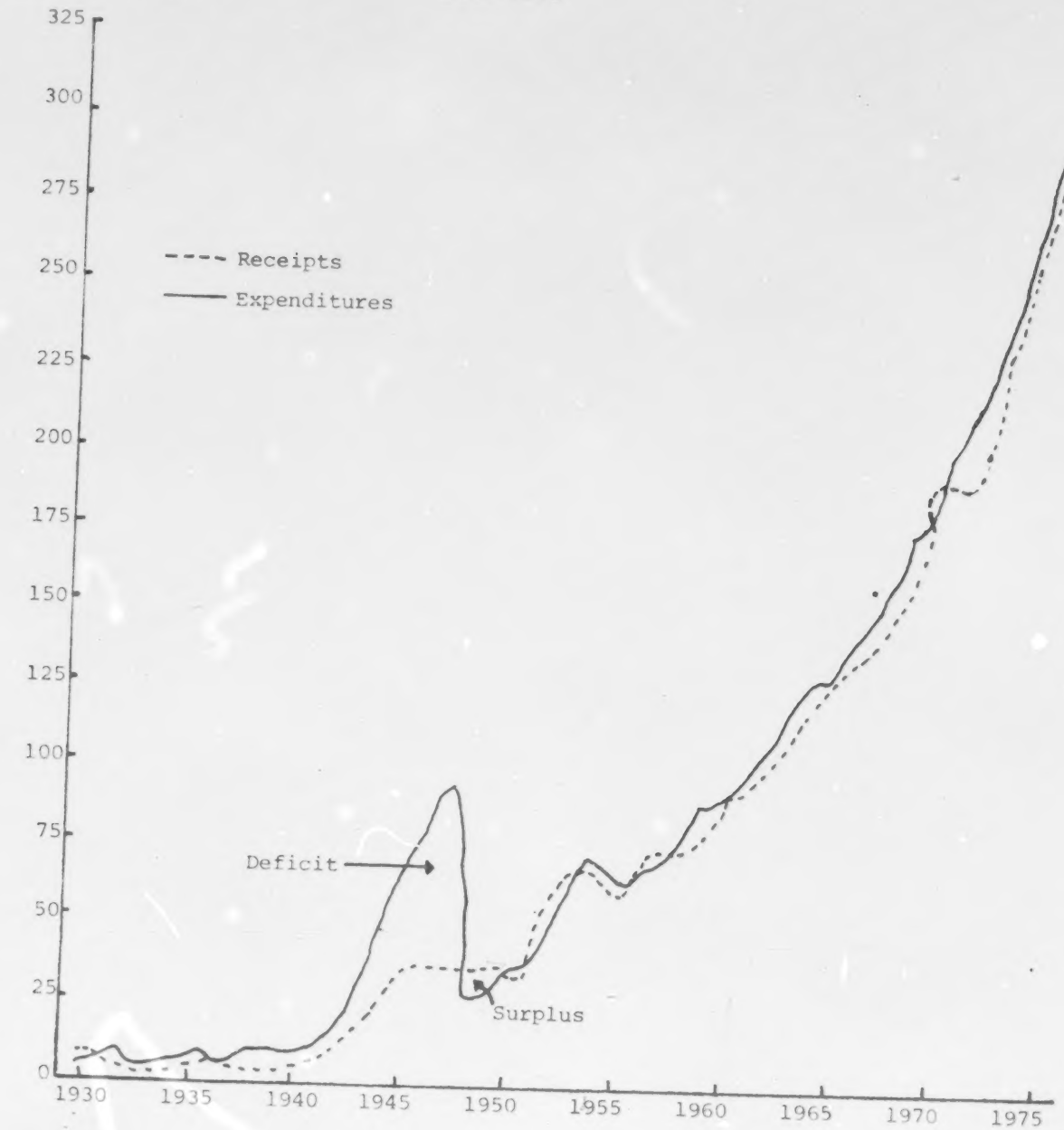
FEDERAL BUDGET
1930-1975



Source: Economic Report of the President, 1974.

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by the federal government is allocated to national defense, and billions of dollars are spent each year for veteran's services and benefits, and for interest on the public debt. The enormous cost of previous wars is unfortunate, but spending for national security by providing for the defense of our nation is a necessary part of our national welfare. On the local level, we have greater demands for schools, streets, sidewalks and public services as a result of an increase in the population. As population increases and the economy develops, we can expect government expenditures to continue to increase.

Chapter 5

OUR MONEY SYSTEM

Thus far we have referred to our economic organizations of business, labor, and government, but little has been said about the money that has to be used in all of our activities. Money is such a routine part of everyday living that its creation and acceptance are ordinarily taken for granted. Everybody wants money. Most people would like to have more of it. We can better understand how our economy works if we know what money is, what backs the U.S. currency, what functions money performs, and how our monetary system works.

What is Money?

We may think of a dime, a five dollar bill, and a check for $22.50 all as money. So they are. At least the bank balance behind the check is money. But money, as we have used it over time, has a broader meaning. The development of money down through history followed this general pattern:

No money used--every family was dependent on itself.

Barter system--families traded goods and services.

Scarce items used as money--leather, beads, and arrowheads.

Valuable metals used as money--gold and silver.

Receipts for gold deposits at goldsmiths served as money.

Government printed money--fully backed by gold and silver.

Government printed money--partly backed by gold and silver.

Government printed money--no backing by gold and silver.

In 1965 the President requested of Congress and received approval to change the metal content of our coins. This is the first time since 1853 that such a change has been made. No changes were made in the penny or the nickel. The dime was kept the same size but contains no silver. It is a sandwich coin with a copper core and faced with nickel-copper alloy. The same size and design was maintained for the quarter with a similar copper core and nickel-copper alloy used as facing for the dime.

Money can be viewed as a tool used to facilitate transactions. Today in the United States there are two main kinds of money in use: (1) Currency (paper and coins) and (2) Demand deposits (checking accounts in banks).

What Backs U.S. Currency?

The currency we have in circulation is backed by valuable metals such as gold and silver and by the credit of the U.S. Government. The paper money (Federal Reserve Notes) we have in our possession can be used to buy things or exchange for other currency. They cannot be redeemed in gold. Private citizens are not permitted to hold gold for monetary purposes.

The paper money is backed to a certain extent by government securities, but more important than the backing in amounts of gold is the stability and confidence we have in the government. A currency is only as good as the government that issues it.

The Functions of Money

What does money do for us? One of the most important functions of money is to aid in buying things. The boy who takes the dollar he received from cutting the lawn and exchanges it for a baseball illustrates money as a medium of exchange.

Money serves as a standard of value. We can exchange goods for a comparable value of other goods. When people set money aside to provide readily available purchasing power for the future, it acts as a store of value. Many contracts are made to pay definite sums of money in the future where money is useful as a standard of deferred payments.

All of these functions make possible a much larger volume of business than if we had to barter one thing for another every time we wanted to exchange something. Our complex economy could not function very effectively without money.

Our Money Supply

The Bureau of Printing and Engraving has the right to make

coins and print paper money. These monies are issued through the Federal Reserve Banks, but they account for a little over 20 percent of our money supply. "Checkbook money" (demand deposits in banks) makes up nearly 80 percent of all money in the country. The total of currency and demand deposits has increased over a period of years to a current value of over $200 billion.

We are interested in having the proper relationship between the supply of money, how fast it circulates, and the growth of the economy. We know too much money in circulation can deflate its value, and too little money can also be a problem. Trying to keep the proper balance is a function of the Federal Reserve Board of Governors and the Federal Reserve System. We shall see how they try to do this later in the chapter after we have considered the operation of the banking system.

Organization and Operation of a Bank

As an aid to getting an understanding of the place of demand deposits in our economy, it may be helpful to study the organization and operation of a bank. After securing adequate capital funds and obtaining a charter from either the Comptroller of the Currency for national banks or from the state, the bank is organized to begin operations.

Banks perform many functions and provide services to customers. They are given important money-creating powers by making loans to aid in the growth and proper functioning of the economy. Banks, however, could not be left free to loan any amount they desire. Too little money in circulation and too much money can both cause problems. The Federal Reserve Board of Governors supervises the loaning procedures of banks to try to maintain the proper amount of money to have our economy function properly.

The actual process of money creation takes place in the commercial banks. When we deposit money in a bank, it has a responsibility (liability) to redeem the checks we write on our account. Banks can build up deposits by making loans and investments so long as they keep enough money on hand to redeem whatever amounts the holder of deposits wants to convert to currency.

> The unique attribute of the banking business to create money was discovered several centuries ago. At one time, bankers were merely middlemen. They made a profit by accepting gold and coins brought to them for safekeeping and lending them to borrowers. But they soon found that the receipts they issued to depositors were being used as a means of payment. These receipts were acceptable as money since whoever held them could go to the bank and exchange them for metallic money.
>
> Then bankers discovered that they could make loans merely by giving borrowers their promise to pay (bank notes). In this way, banks began to create money. More notes could be issued than the gold and coins on hand because only a portion of the notes outstanding would be presented for payment at any one time. Enough metallic

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money had to be kept on hand to redeem whatever volume of notes was presented for payment.[1]

Deposits are the modern counterpart of bank notes. It was a small step from printing bank notes to the current process of making book entries crediting borrowers with sums of money which could then be spent by the use of checks.

If deposit money can be created so easily, what limits how much a bank can loan? The amount is based on the legal reserves a bank must maintain to have a prescribed percentage of deposits. How do operating needs and legal requirements affect the amount of deposits that the commercial banking system can create? The public's demand for currency is quite predictable. All banks taken together, there is no net drain of funds through clearing. A check drawn on one bank will normally be deposited to the credit of another account in the same or another bank. The main factor, therefore, which limits the ability of the banking system to increase demand deposits by expanding loans and investments is the reserves that banks must hold against deposits.

Growth of deposits can continue only to the point where existing reserves are just sufficient to satisfy legal requirements. If reserves of 20 percent are required, for example, total deposits can expand only until they are five times as

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[1]Federal Reserve Bank of Chicago, Modern Money Mechanics, May, 1961.

large as reserves. Ten million dollars of excess reserves (reserves in excess of the 20 percent requirement) could support up to $50 million of additional deposits. The lower the percentage requirement, the greater the expansion power of each reserve dollar. It is this "fractional-reserve system" that sets the potential and the limits to money creation.

Route of a Check

The banking system throughout the country makes it possible to cash checks almost any place with the proper personal identification. If you were in the community of Urbana, Illinois, and wanted to cash a check at Smith's Supermarket, the Federal Reserve System would act as a clearing house. You make your purchase and write a check for $10 to Jack Smith, the owner of Smith's Supermarket. Mr. Smith deposits the check to his account in the Urbana Bank so his account is increased by $10. The check then goes to the Federal Reserve Bank to be cleared. The account of the Urbana Bank is increased by $10 and the account of your bank is decreased by the same amount. Your bank then deducts $10 from your account and sends you the cancelled check. The following diagram shows the route of a check to clear through the Federal Reserve System.

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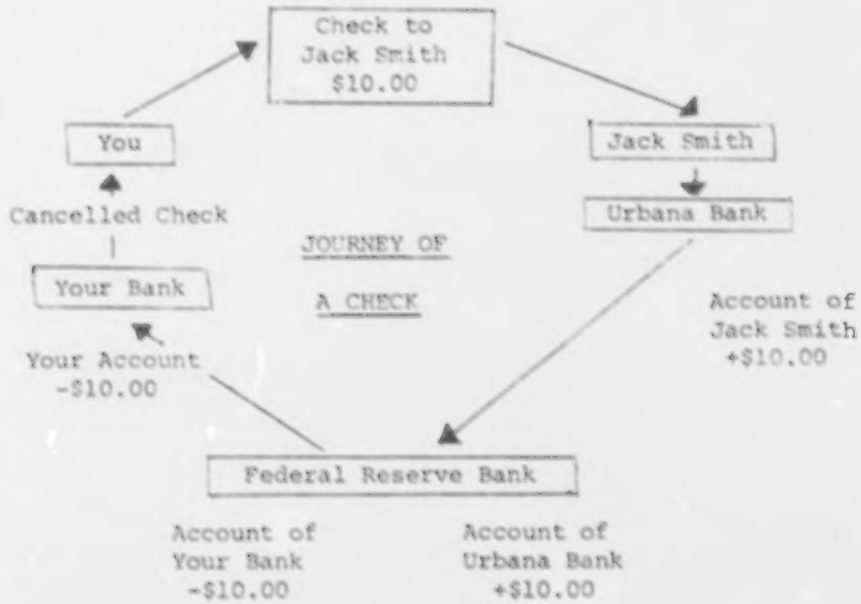

In the large cities where there are a large number of banks, the business of sending the checks around for collection would become troublesome. Each bank would have to send a messenger to each of the other banks. To save labor and expense, the bankers invented a clearing house. It is an association of the banks of a city through which all the accounts between the banks for accepting each other's checks are settled. The clerks make out a list showing the amount due from each bank or the amount due to the bank. Then the bank makes one settlement. These clearing houses greatly simplify the banking check system.

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The Federal Reserve System - The Protector and Controller of Our Money System

The Federal Reserve System is the foundation for our money system. In 1913 it was established to supervise and strengthen the banking system. It now consists of a Board of Governors, twelve district banks, and about 6,500 member banks:

FEDERAL RESERVE SYSTEM

BOARD OF GOVERNORS
7 men--14-year terms
Operate 12 districts

PRESIDENT
Appoints members of board

CONGRESS
Passes laws for system

The Federal Reserve District Banks do not operate as private banks, and they do not accept deposits of individuals. They are primarily a bank for banks. Member banks use their reserves in the same way we use our checking account. Reserves are increased or decreased by deposits or withdrawals.

The Federal Reserve System influences the economy using three basic tools: discount rates, open market operations, and reserve requirements. Each is shown in the following illustration as it is used to speed up or slow down business activity.

TO SPEED UP BUSINESS ACTIVITY	TO SLOW DOWN BUSINESS ACTIVITY
1. Decrease discount rates (the interest rate charged by the Federal Reserve to member banks in borrowing money). When rates are low, member banks are encouraged to borrow. This allows the banks to make loans to individuals and businesses, thus increasing the money supply.	1. High discount rates discourage borrowing and thus fewer loans are made and the money supply is decreased.
2. Open Market Operations (buying government bonds from individuals and companies in the open market). It increases the money supply to buy bonds.	2. Selling bonds to individuals and companies decreases the money supply.
3. Fixing Reserve Requirements for Member Banks. (Determination of the minimum amount a member bank must keep in reserve.) Reducing requirements increases the amounts banks can lend.	3. Raising reserve requirements reduces the amount of money a bank can lend.

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Banks of the Federal Reserve System are required to insure their deposits with the Federal Deposit Insurance Corporation up to a maximum of $20,000. The insured banks pay assessments that provide the insurance reserve. Each account for every person is insured. For example, one person may have an account of $20,000 in each of three banks. All of these accounts are insured by the F.D.I.C.

A safe money supply is vitally important for the successful operation of the economy. The services that banks perform are far-reaching in their effects. By permitting loans to certain individuals, banks encourage particular kinds of businesses; or by denying loans to others, they discourage other businesses. Banks encourage saving by providing a safe place to deposit money. In issuing credit, banks become a main force in stimulating and carrying out business transactions, and in influencing how goods and services are produced.

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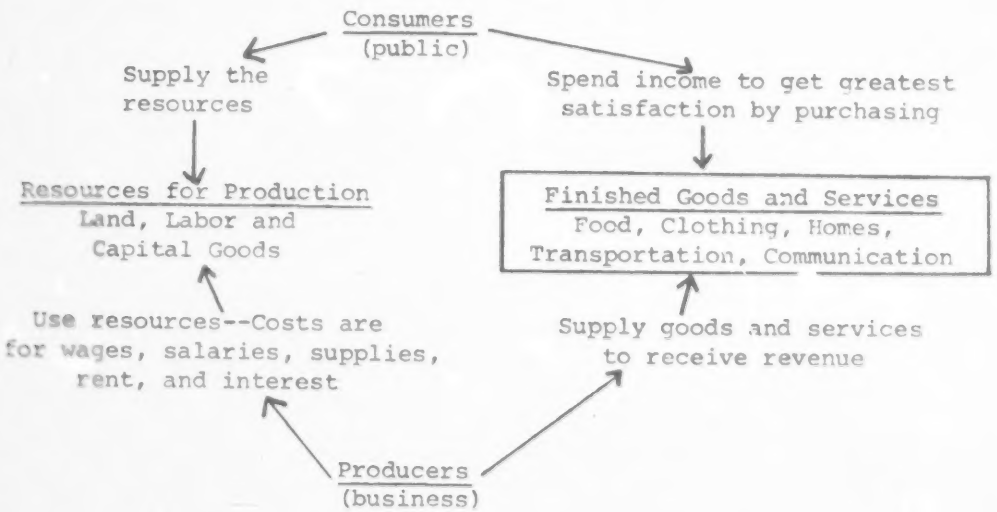
Chapter 6

HOW GOODS AND SERVICES ARE PRODUCED

Our economy in operation with the large number of businesses, millions of people, and different organized groups is a complex system. It is interesting to try to visualize oneself in different roles as worker, consumer, manager of one's own business, congressman, or even the President. Think of the challenge of these responsibilities and the interdependence of each of us in our specialized economy.

An Overall Picture

Several have tried to show the relationship of different parts of our economy in diagram form. Here is an example:


Consumers
(public)
Supply the resources
Spend income to get greatest satisfaction by purchasing
Resources for Production
Land, Labor and Capital Goods
Finished Goods and Services
Food, Clothing, Homes, Transportation, Communication
Use resources--Costs are for wages, salaries, supplies, rent, and interest
Supply goods and services to receive revenue
Producers
(business)

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The producer takes land, labor, and capital and tries to combine them into something useful. They cost him money; but when he sells what he produces, if he has done an efficient job, he usually receives enough money to pay all his expenses including a return on the money he has invested and a payment for his time and effort. The consumer is interested in what is produced. Consumers usually spend their money to get the most satisfaction out of their income. Both groups are influenced by such organizations as labor unions, banks, manufacturing companies and government. In this chapter we will be primarily concerned with the producer of both goods and services.

Our Resources

Whenever we think of production we think of resources. In order to produce, it involves the combined effort of labor, machines, and natural resources. The following is a common classification:

Resources

Natural	Capital
land	human (workers, their skills and attitudes)
minerals	machines
water	buildings
timber	inventories

Natural Resources

The demand for natural resources has been growing rapidly for the last few years and it will likely continue to grow in the future. The primary reasons for the increase are the growing population and the higher level of living.

The cost of supplying raw materials has increased. High quality resources have been used up and it costs more money to develop the poorer quality resources. New materials and substitutes have been developed, but there is an urgent need to develop resources to meet the energy crisis and have adequate resources to be more self-sufficient in the future. Programs have been approved to accomplish the desired goal of providing more of our own needs and depending less upon other countries. Even though some of our resources will be more costly to develop than we would have to pay if purchased from other areas, our experience in the past few years emphasizes the importance of developing our own resources.

Capital Resources

While natural resources constitute the basis of all production, in themselves they are not very productive. We must have machines, buildings, and equipment, but more important are the people who use them. People possess a greater potential for development than other resources, so it is the population, number of workers, their skills and attitudes that account for the real potential. Human resources are often classified with other capital resources in showing how goods and services are

produced.

It is of interest to see the growth of the population and the labor force. From 1930 to 1970 population increased 82 million and the labor force increased by 36 million. Projections have been made that if the rate of increase that took place in the 1960's continues, there will be about 360 million people in the United States by the year 2000. If the population and likewise the labor force were nearly doubled, try to visualize the adjustments that would have to be made in our economy.

Year	Population	Labor Force (including Armed Forces) Millions
1930	123	50
1940	132	56
1950	152	64
1960	181	72
1970	205	86

Source: Economic Report of the President, 1973

Just numbers of people and potential workers are not enough. The training, skills, education, health, and attitudes are important. A large population in an underdeveloped country cannot be productive if they are illiterate, undernourished, and do not have skills. We have been interested in investing money in people. Individuals, businesses, and government groups have realized the importance of vocational and college training.

Education is in the midst of a big boom. Where a high

school education has been a standard of attainment. It is now clear that college work and vocational training in specialized fields are becoming common goals. Employers have raised their educational standards. Parents know that their children will have to have more schooling to enter successful occupations and professions.

A variety of figures have been published to show the advantages of education:[1]

Education	Average Lifetime Earnings
Graduate study--one or more years	$ 823,759
College graduate	710,569
High school graduate	478,873
Elementary school only	343,730

The difference between a high school and college graduate in lifetime earnings is $231,696 or 48 percent more for the college graduate. High school graduates get $135,143 more in lifetime earnings than those with an elementary education. Education is not only a good investment, but is an important key to the nation's economic growth. Human capital (skill and training) is as important as capital in the form of buildings and equipment. Several studies have been made to estimate the contribution of education capital. The results show that about one-fifth of the rise in national output can be attributed to rising educational levels of the labor force.

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[1] Finance Facts, National Consumer Finance Association, May, 1974.

Even if people are skilled and well-trained, opportunities to work must be available to them if we are to have a healthy economy. The businessman to employ people must have buildings, equipment, and a potential market for his products. Capital resources must be available to carry out his plans. He depends on a politically stable and developing economy.

The businessman must have funds to start and operate his business. He usually invests some of his own money. He can get others to be his partners. He may sell stocks so others can be part owners. He can borrow from financial institutions such as banks, insurance companies, or savings and loan associations. Whatever the source, he tries to use the funds to employ the resources that will give him a good combination and proper balance to be an efficient producer.

Specialization and the Importance of Savings

Savings and investment are necessary for the production of capital in the form of buildings and machines. Modern specialization requires large amounts of capital equipment. When the United States first became a nation, approximately 90 percent of the population lived on the farm where most families raised their own food, made most of their clothing, and built their own houses. Now there are only about 5 percent of the people that live on the farm. The balance have

specialized jobs and are dependent upon others for their livelihood. The production miracles of the modern day could not be accomplished without specialization which makes possible the development of skills and permits the concentration of skills where they can be most effective.

Take the case of a businessman who ordered a crate of pencils from a manufacturer to use in his business. What went into those simple pencils? It couldn't have been much because they only cost a nickel each. He thought of a few of the operations that it took to manufacture one pencil.

a. Pine trees were logged, cut, and shipped to the pencil industry.

b. Graphite and lead were mined where they were refined and processed before they were shipped to the pencil company.

c. Paint was purchased from another company which had already assembled many materials to produce the paint.

d. Erasers and metal to hold the erasers had to be purchased from manufacturers who had mined, refined, and processed the rubber and the ore.

Even for a simple item of production such as the pencil there are many areas of interdependence in the economy. This interdependence has come about because of specialization. Work has become more and more specialized in our industrialized economy, and over the past one hundred fifty years this specialization has increased production. Machine power has become the secret of productivity and has increased the growth in output per man hour. Our society now produces over five times as much in each hour worked as it did in 1880. Since 1947 the output per man

hour has doubled.

Influence of Automation

The increased use of machines has replaced workers and caused some to have to get other jobs. The substitution of machines for men is often referred to as automation. The influence of automation is viewed from different points of view: "Automation spreads fear among workers." "Automation puts 40,000 out of work every week." "Automation gives workers in the U.S. more leisure time." "Automation is inevitable to meet world competition." "Automation: a job creator or a job destroyer?" These were titles for a series of articles that were published to try to show that there are different ways of looking at the adjustments that are necessary as we use more modern methods. It is not clearly established as to how much influence automation has had in throwing men out of work or creating jobs over a period of time, but there is general agreement that modern methods have contributed greatly to our ability to produce. The study of the adjustments helps to appreciate others' points of view.

When a man's job is taken over by a machine, it is argued by some that the organization he has worked for and society have some responsibility to help the worker find a new job. Many businesses have developed retraining programs. Others have assumed at least part of the financial responsibility for

sending workers to school. Government groups have organized programs to aid workers to meet the adjustments brought about by automation.

Using Our Resources to Meet Our Needs

The future of America depends on the wise use of our resources. The quality and quantity of people possess a great potential for development. Natural resources are important to continue productivity at a rapid rate. The demand for these resources has been growing rapidly, so they should be used wisely. Erosion can quickly destroy the topsoil which has taken nature thousands of years to produce. The increasing demand for mineral resources, water, and recreational facilities means an appreciation of conservation, both from an individual and from society's point of view.

Tools, machinery, equipment and the ability of workers to run them have been responsible for the expanding productivity of our economy. Capital resources have increased output per worker significantly. The nation's capital stock will continue to increase and the income will rise as long as Americans remain eager to provide for the future by investing in new and better ways of producing goods and services.

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PART II

PRICES AND MARKETS

Chapter 7

HOW WE SHARE WHAT WE PRODUCE

As we have studied our economy, we have learned because our wants are unlimited, we try to satisfy as many as we can with the resources that are available. We learned in Chapter 6 how goods and services are produced. We now want to consider how we share our income, the importance of incentives and profits, how we reward those that supply labor, own land and capital, and the influence of all of these on productivity. In Chapters 7 to 9 we shall consider the individual, the business and the industry, known as the microeconomic approach. In Chapters 10 to 12, emphasis will be placed on macroeconomics by studying the whole economy.

Incomes are used as a measure of the value of what we produce. Incomes in total, per family and per capita, have increased consistently since the great depression of the 1930's. Some of the increase can be explained by changes in the value of the dollar since figures are often given in current prices. We can show actual increases by using a base year such as 1958. Even with corrections for price level changes, incomes have increased substantially since the 1930's. Changes in per capita disposable income (income after taxes) for both current prices and 1958 prices are shown on the following chart.

PER CAPITA DISPOSABLE INCOME--SELECTED YEARS

Year	Current Prices	1958 Prices
1929	$ 683	$ 1,236
1933	362	893
1940	573	1,259
1950	1,364	1,646
1960	1,937	1,883
1970	3,376	2,610
1973	4,195	2,890

Source: Economic Report of the President, February 1974.

How We Share Our Income

One way to look at the distribution of income is to show the percentage of families by income groups. By using the value of the dollar for 1965 as a basis for comparison, we make corrections for price level changes. The percentage of families making $10,000 or more increased from 7 percent in 1950 to 25 percent in 1965. The increase in the $7,000 to $10,000 level was from 13 to 24 percent. There was a decrease in the proportion of the families in the lower income brackets from 1950 to 1965. The same general trends have continued since 1965.

Another way to analyze the distribution of income is to show the percentage of the total income that is received as wages and salaries, profits, interest and rent. Over a period of years the most important source of income has been wages and salaries followed by corporate profits and inventory valuation, proprietors income such as that from owners of business and farmers, interest payments and rental income of persons in that order. The following breakdown shows the average over the past few years.

Compensation of employers' wages and salaries	71%
Corporate profits and inventory valuation adjustment	13%
Proprietors' income business and farms	9%
Interest payments	4%
Rent income to persons	3%
	100%

Compensation of Employees

With the developments in our economy and changes in the distribution of income, there have been adjustments that influence workers. Production has increased through specialization which has caused greater interdependence among workers. Business leaders have recognized the potential of development of people by using training programs for their workers. Labor

unions have encouraged vocational training and government groups have promoted retraining programs.

We know that incomes are not distributed equally, nor should they be if our economy is to be free. Wage differentials are common due to differences in skills, education, health, experience, efficiency, and monopoly power. Workers are not always aware of these differentials. Even with a knowledge of the differences, workers do not easily move to better jobs. Attachments to friends or areas are not easily broken and often the opportunity for higher income is sacrificed.

Important in analyzing our economic system is the relationship of the labor force to workers employed and those that are unemployed over a period of time. The difference between the labor force and the number employed represents the percentage unemployed as shown by the following information.

CIVILIAN LABOR FORCE, WORKERS EMPLOYED AND UNEMPLOYED

Year	Civilian Total Labor Force Millions	Employed	Percent Unemployed
1930	50	45	8.7
1935	53	42	20.1
1940	56	48	14.6
1945	54	53	1.9
1950	62	59	5.3
1955	65	62	4.4
1960	70	66	5.5
1965	74	71	4.5
1970	83	79	4.9

Source: Economic Report of the President, 1973.

The rate of unemployment that allows for changing jobs and normal adjustments in the labor force is not considered alarming when it is maintained between 3.5 and 4.5 percent. There have been periods when the rate was much higher, such as 1933, when unemployment was as high as 25 percent. Since World War II unemployment has been over 4.5 percent in the years 1949, 1950, 1954, and 1958 to 1965. The highest rates of unemployment were in the recession years of 1958 and 1961, when they were nearly 7 percent. Even during the relatively prosperous years in the 1958 to 1965 period, the rates were high when the unemployment for unskilled workers was considered a major problem. Since 1965 the rates have been within an acceptable range.

The unemployment problem can be looked at more closely if related to the educational level. The more the years of education, the less the unemployment. This relationship exists for both the younger and older members of the labor force and for male and female workers. Little difference exists betwen male and female workers by educational level. The percentage of women in the labor force, however, has been increasing. In 1960, women accounted for 32 percent of the labor force compared to 34 percent in 1965 and an estimated 35 percent by 1975.[1]

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[1]National Industrial Conference Board, Road Maps of Industry, No. 1402.

The major unemployment problem is with the unskilled workers, particularly the non-white younger workers. More attention will be given this problem in Chapter 15.

Profits

Profit is the reward for initiative and risk bearing. There are differences of opinion as to whether profits are too high or too low, but some compensation must be paid to get people to take a chance to make new products or develop new methods. Taking the risk can result in making a profit or losing money, so the American economy is really a profit and loss system.

In a private enterprise system, profits are the stimulus for owners and managers to render their services. If everyone was convinced that there was no hope for making a profit, there would be no incentive to organize a business. How much profit is necessary to cause businessmen to assume the risk is not known. It is clear that some groups, because of their monopoly position, must be regulated to keep profits at reasonable rates.

Over a period of years, profits have increased, resulting in more dividends to stockholders. Most of the increase, however, has been paid out through higher income taxes. The undistributed profits that are kept by businesses to expand their facilities have been fairly uniform for the past 25 years.

Interest

The production of new equipment must be motivated by a reasonable expectation of return. Interest rates vary greatly on different types of loans. The degree of risk, the administration costs and the extent of competition among lenders and borrowers influence interest rates. The U.S. Government, as the most important borrower and lender of funds, and the Federal Reserve Board of Governors that has the right to set discount rates, influence the interest paid on loans.

Although interest only accounts for about 4 percent of the national income, it has influence on whether plants will be expanded and if more people will be employed. Our understanding of interest and its contribution to society has changed since ancient Greece when it was considered unnatural to accept payment for money loaned. The influence of interest rates in the economy as a whole will be presented in Chapter 11 when we consider monetary policy.

Rents of Land and Buildings

Rent of land is determined primarily by the productivity of the land resulting from either fertility or location. Productive land yields high rents and people are willing to pay high prices for its use. Changes in the price of products that land produces changes the rent. The land yielding the highest rents is that

in busy city locations with access to large numbers of customers.

Rent paid to the landlord is a payment to cover interest on the building and investment costs of upkeep and taxes. What is left over represents rent for the use of land on which the building stands.

Rental income of persons accounts for 3 percent of our national income, but the supply of good land is limited. The use of land for highways and cities will further reduce the supply and increase the return it can demand.

Productivity, the Basis for Compensation

The contribution of land, labor, and capital to production will influence the rent, wage rate, or interest that is paid. If machinery becomes more productive than labor, the tendency is to use more machinery. As the more productive land is in greater demand, less productive acreages will be used.

With the best use of resources and increased production there are several ways the benefits might be distributed. One would be to give them to the managers as salaries, the owners as dividends, or plow back the earnings into the business. Another would be to grant wage increases to the workers. A third would be to pass on the benefits to consumers through more products and lower prices. A fourth and more practical

solution would be some combination of these where all concerned could share the benefits.

Total social benefits could be maximized if the gains from production were passed on to consumers in the form of lower prices. However, to get a motivating effect on the part of management and labor, there is some justification for higher wages and profits. The problem arises when some groups want more than an increasing proportion of national income and use monopoly tactics to accomplish these goals. When labor unions obtain increases in wages and benefits beyond increases in productivity of workers, inflation is likely to result. Any additional payments made to them beyond their own increased productivity come out of profits or result in higher prices.

Employers, on the other hand, are generally unwilling to allow their profits to be cut. They insist that the major cause of increasing production is better equipment and organization they have provided, so that an adequate return is both justified and necessary as motivation for them to introduce these improvements.

Productivity improvements have played an important part in bargaining for and in the granting of periodic wage increases. Productivity is accepted by some government officials, business executives and union officals as a good basis in wage bargains; but the economic validity of using productivity per man hour

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alone can be challenged since capital, management and shifts of resources from lower to higher use should be considered.

How then shall the gains of increased productivity be shared? The market-oriented economy seems to provide the best environment to reward the most productive resources and to price goods and services. The planned or command economies in many parts of the world are turning to features of the market system to try to increase productivity.

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Chapter 8

HOW COMPETITIVE IS OUR ECONOMY?

A substantial part of the production in the United States is handled by relatively few large organizations in some industries; but because of the economies associated with large organizations, products can be improved and sold at lower prices. There are dangers of monopoly power where groups influence the output and the price. Labor organizations also can contribute to efficiency or can have policies that interfere with the best use of labor. Governments can play the role of encouraging competition, but sometimes they are accused of using controls that discourage production and marketing. How competitive is our economy? Before we consider some examples, let's look at the broad meaning of competition, monopoly, and imperfect competition.

Competition

Competition means different things to different people. We use various methods to try to reduce competition, but it is still one of the important influences in the development of our country.

A purely competitive market is one in which there are so many buyers and sellers that no one of them can affect the

price. Markets are the results of actions taken by buyers as a whole in relation to the actions of all sellers. The markets for major crops except as modified by government action, are of this type. Farmers produce millions of bushels of wheat. Even the largest producer of wheat would have no measurable influence on the market if he decided to quit producing. Agriculture as an industry comes closest to a purely competitive situation in our economy.

Monopoly

We do not have pure monopoly except in authorized public utilities. As large as businesses become, there are other sellers in the market. In a pure monopoly, one seller controls the supply. By limiting the amount offered for sale, he can influence the price. Where the influence of the monopolist can be identified, he is subject to government regulation. The pure monopsonist (one buyer) may hold down the prices he pays; but if he places them too low, he may be unable to purchase all he wants and may also discourage producers, thus reducing his source of supply.

Imperfect Competition

Between pure competition and pure monopoly there is a wide range of variation of competitive conditions and monopolistic power tending in various degrees toward two special

types of situations affecting price. These are product differentiation and oligopoly.

Product differentiation is developed in the minds of buyers. Products or services of one seller differ in quality from those of other sellers. The buyer may be willing to purchase the goods or services he believes to be superior at prices above those of competing products. Quality differences may be either real or imaginary.

Differentiation may be weak or strong. If a large number of buyers are convinced that a particular brand of pain reliever is superior to others, it will be possible to charge a price for the favored brand that is relatively high compared with others. An example often used is with aspirin. On the other hand, if buyers feel there is little difference, the prices cannot vary greatly because buyers will tend to purchase the lower priced product.

Oligopoly means a situation where there are at least a few and often several sellers, each big enough to have a large influence on the price of the commodity they all sell. In our economy, where contracts to maintain an agreed price or to share the market are illegal, the tendency is for any one of the group of sellers to cut prices to increase sales. A common pattern, however, in such situations seems to be to agree informally on a price that looks moderately profitable, thus reducing price competition and leaving non-price competition

such as advertising and product design in effect. Competition in improving methods may still exist where the organizations which are most successful in reducing costs commonly put a downward pressure on the price.

Many industries follow the leader who sets the new price. The price leader may have no collusive contracts whatever with his competitors. On the other hand, one of the simplest devices known to reduce competition is for competitors to agree not to cut prices below a certain figure.

Fair trade laws have been passed designed to reduce competition. Certain manufacturers were interested in controlling the prices of their products right through the retail level. Although the movement for such resale price maintenance originated with manufacturers, the growth of chain stores and price cutting practices of some businessmen generated pressure among independent retailers and wholesalers for laws restricting such price cutting.

Government Regulation

Agreements of sellers to control prices have been illegal in our country for many years. Our legal system is based on the common law of England, which prohibits restraint of trade. Our courts have supported the basic law along with the Sherman Anti-Trust Law which formed the basis for both competition

and monopoly in our economy. Actually, towards the end of the nineteenth century the rapid growth of large business organizations of nationwide operation with these controlling units made it necessary to pass the Sherman Anti-Trust Act in 1890 which provides:

1. Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states or with foreign nations, is hereby declared to be illegal.

2. Every person who shall monopolize, or attempt to monopolize or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states or with foreign nations shall be deemed guilty of a misdemeanor.

Some would argue that the Sherman Act is outdated. We need new legislation, they say; but the Sherman Act, like any other act, means what the courts say it means. The interpretation depends heavily on the social philosophies of the judges who reflect other social philosophies. Their philosophies have changed over time, but the Supreme Court has had the responsibility of making key interpretations.

The first important decision handed down by the Supreme Court in regard to anti-trust was in 1895. The Court held that the Act did not apply to a combination of manufacturing, insisting that manufacturing is not commerce. The court admitted that the defendant in this case, the American Sugar Refinery Company, had acquired nearly complete control of the manufacturing of refined sugar in the United States. With

this interpretation, the Act was practically meaningless until the decision was reversed ten years later in the "Beef Trust Case" involving the large meat packers. More support for this Act was given in 1911 with the court's rulings of Standard Oil and the American Tabacco cases. A more recent case involved the electrical equipment manufacturers who were convicted of having conspired to fix prices and divide markets.

Different groups have been set up in our economy to set policies and operation programs relating to competition. They exercise control through organizations knowing they might be investigated. Some of them are:

1. Interstate Commerce Commission regulates rates, fares, and routes of transportation facilities.
2. Securities Exchange Commission supervises the stock market.
3. Federal Communications Commission has regulating power over radio and television.

The Case For and Against Bigness

Most other advanced industrial countries have tolerated considerable restraint on competition and even encouraged trade associations designed to divide markets among members and assure high cost organizations a share of the market. In the United States there has been more concern about monopoly and the influence of large scale business.

There are some advantages of large scale production.

In most situations a large factory can produce more efficiently than a small one. Efficiency in production means that the cost per unit of output is low. A large factory often produces a better product. A mechanic using simple equipment could not hope to produce a modern automobile similar to those rolling off the assembly lines in our large factories. Frequently a large machine can produce considerably more than a smaller machine of the same type.

A large organization is able to conduct expensive research, do national advertising, hire the best management and enjoy economies of buying and selling. All of these may contribute to lower costs per unit.

A specific case illustrates how costs of manufacturing a thousand pounds of milk made into cheese can be reduced in the larger plants. The comparable costs of manufacturing milk into cheese in the smallest plant was nearly double that of the largest plant. When the costs of management, labor, capital

Average Daily Volume	Management	Labor	Capital	Supplies	Total
15,600	$.42	$3.42	$2.80	$1.87	$8.51
31,200	.35	2.93	1.79	1.78	6.85
46,900	.31	2.90	1.47	1.74	6.42
56,200	.30	2.75	1.34	1.70	6.09
75,000	.29	2.60	1.24	1.68	5.81
93,700	.28	2.48	1.19	1.65	5.60
112,500	.27	2.40	1.14	1.60	5.41
150,000	.25	2.25	1.15	1.57	5.22
243,700	.19	1.96	1.00	1.53	4.68

Source: Glen T. Nelson, "Input-Output Relationships of Specialized Butter-Powder and Cheese Plants," Oregon State College Bulletin 32, July 1954.

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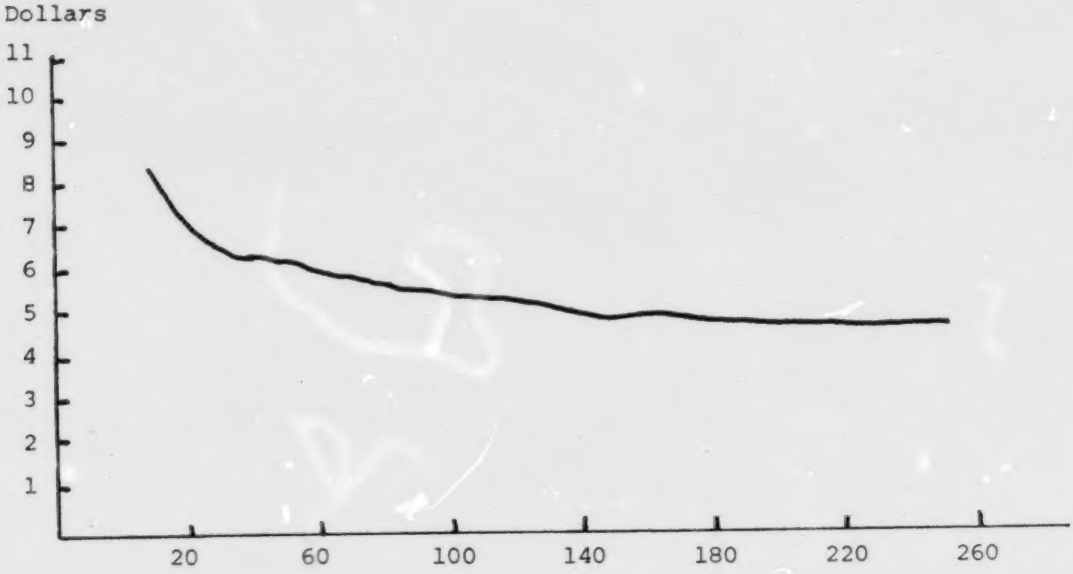
and supplies are added together, the smallest plant had to pay $8.51 to manufacture 1000 pounds of milk into cheese, compared to $4.68 for the largest plant. If the smaller plants decided to combine, it would be possible to reduce the costs per unit of product manufactured; and they would be in a more competitive position. When the total cost figures for each sized plant are plotted on a graph, it shows an economies of scale curve. In other words, it shows how costs per unit can be decreased in a large plant.



The information presented does not show the curve at a size when the cost per unit might have increased. The curve may go up, indicating costs are increasing when a factory is too large. This could happen with the size too large, so we would

have diseconomies of size. In this particular case the largest plant was not of such a size to experience diseconomies, but there are cases where large plants may not be the most efficient unit.

Where output is concentrated among a few organizations, competition may not occur. On the other hand, the cases of the automobile, refrigerator, and soap industries are used to show that there is still intense competition. While monopoly may threaten the foundations of the private enterprise system, there are circumstances in which with proper controls, it appears to be the most appropriate way to operate, particularly in the fields of public utilities and transportation.

There is a problem, too, that with ruthless competitive methods, competition can be crushed and monopoly power can be achieved. Such cutthroat competition in the long run is an instrument of monopoly rather than competition.

Consumers may be lead by false advertising to buy poor quality at expensive prices. Powerful firms have used price discrimination to ruin competition, temporarily lowering prices in certain communities to destroy competition, then boosting prices to monopolistic levels.

Other methods of unfair competition include boycotting and blacklisting organizations that refuse to participate in price control programs, paying secret commissions, or bribing employees of competitors. Methods used by some labor unions in dealing

with management are sometimes questionable when picketing, boycotting, the union label, sabotage, and racketeering are used. Unions have at times taken action to restrict competition facing their employers by urging tariffs and other legislation. Employers in turn have sometimes used direct pressure on workers and unions to gain an advantage.

There are, however, good reasons for vigorous competition among large organizations. The hard fight to move ahead and stay ahead of rivals stimulates technological development and growth. The incentive and desire encouraged by competition has proven to be one of the key reasons for the ability of our economy to grow rapidly.

Conclusions

There is probably no other country in the world in which competition is more vigorous than in the United States. Contrary to Marxist theory that big business will gain power at the expense of the common people, the number of businesses in our country continues to grow. Most of the organizations are of modest size. They have a good record of efficiency and the ability to meet the competition of their larger competitors. Many large companies buy their parts from smaller producers. Growing markets can improve competition. International Harvester, for example, in 1911 had 75 percent of the market for farm machinery. This company has grown tremendously, but today it supplies only about 25 percent of the machinery used by farmers.

There are many other examples similar to International Harvester, but there are also cases where one or two business groups produce a large percentage of the product marketed. The fact that our economy has developed so well in recent years with the number of small businesses increasing does not guarantee that a competitive situation will continue. There will be a need for rules of competition to be enforced by government groups.

Chapter 9

OUR PRICING SYSTEM

In our economic system we use prices to show values. Prices are expressed in such ways as wages for the contribution of labor, interest for the productivity in the use of money that is converted to machines or buildings, and prices of the things we buy or sell. Prices perform definite functions in our capitalist-oriented society.

Functions of Prices

Prices are regulators of economic activity in a free enterprise system. Consumers in spending their incomes influence what and how much is produced and sold. The responses of producers and consumers to price changes serve to regulate production and guide consumption.

Regulating Production

High prices encourage production and low prices tend to reduce the amount produced. There are other motives to produce. An artist may paint for the joy of his accomplishment. A farmer may produce fine cattle for the satisfaction of his efforts or for recognition. But for most people financial rewards are necessary motives.

As workers, we find that we look for the opportunities

to sell our services where we can get the best wages if working conditions are satisfactory. We look for investments that will give us the best returns on our savings. All production enterprise involves risks so compensation for risk taking is necessary.

Within reasonable limits, the higher the prices that will be paid for labor, capital, and land, the greater the quantity that will be offered for sale. Relative prices of different commodities largely determine what and how much is produced. Prices then act as a regulator of production.

Guiding Consumption

On the same basis that the prices for the use of land, labor and capital in the form of rent, wages and interest regulate production, prices of finished goods and services guide consumption. One of the most important ways to encourage buying is to lower the price.

On the other hand, if the things we want are scarce, the price is higher; and we consider the alternatives before we buy. Prices serve as a rationing device among buyers channeling commodities to the highest bidders or guiding their utilization to the more needed user. When prices are high we usually buy less or when they are low we tend to buy more.

As consumers we spend our incomes for the things we enjoy most. We have different preferences and are influenced by

different things, but whatever we buy is really casting a vote to have more of that item produced. Businesses and the government are also consumers since they purchase goods and services. The producer responds to consumption decisions and combines labor, capital, and land to give us a variety of products.

How Prices Are Determined

The competitive market for a commodity is a combination of what sellers offer (supply) and what buyers are willing and able to pay (demand) at different prices. Demand is more important in determining price in a certain market on a particular day since it takes time to adjust supply. In a longer period, all costs of production and the influence of technological development become more important influences on prices. Differences in the tastes and desires of people, their incomes and changes in population must be considered in addition to costs of production in determining prices. Understanding how the market works shows how adjustments are made through demand and supply.

The manner in which price acts depends on the kind of market in which it is determined. Some markets are highly competitive where there are many buyers and sellers. Withholding goods by a single seller or ceasing to purchase by a single buyer has no measurable affect on the market. The price tends toward the production costs which include a normal

operating profit. If profits are abnormally high, more sellers will be attracted and others will expand production, forcing prices down. If prices are lower than costs, some producers will drop out and others will reduce their production toward the equilibrium level.

Even in a competitive market, the government, by using such things as price supports or minimum wages, may hinder the free market operation. There are good reasons for using programs of this type, but there are also disadvantages and delayed adjustments in the market.

Some markets are monopolistic where producers have a degree of control and the actions of competitors must be considered. Under these conditions supply and demand do not operate freely. Businesses may engage in both price and non-price competition. As we have seen, if individual groups get out of line, anti-trust laws are often used to encourage competition.

In our modern society when prices are increasing rapidly we often read and hear that certain groups are taking advantage of consumers. The case of marketing costs in relation to food prices is an important current issue.

Marketing Costs--Are They Too High

A few years ago a national magazine published a cartoon that gained widespread attention. It showed a farmer on one

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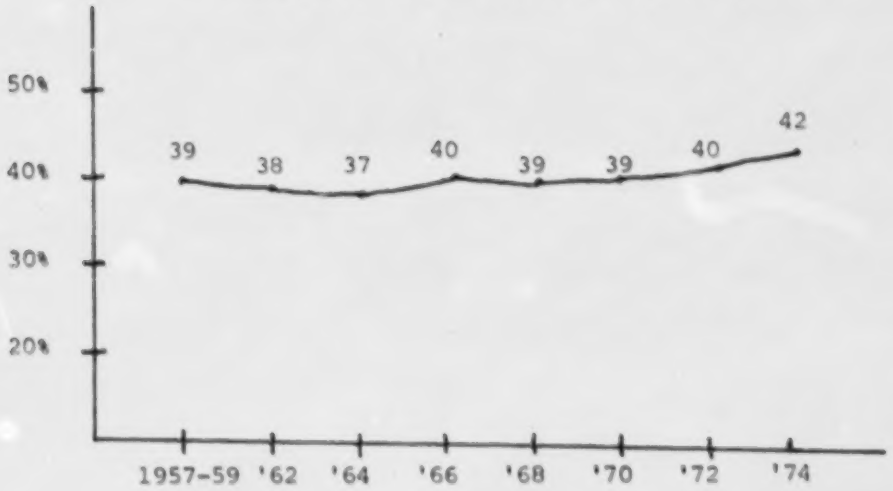
side of the picture selling his product at a low price. On the other side the consumer was paying a high price for the same product. In between the farmer and the consumer was a large black area with a question mark. The caption at the top was, "What Happens in the Dark?"

Why should farmers receive low prices when consumers are paying higher prices for food? Why have food marketing charges increased so fast, making food prices so high? Could it be that the farmer is taking advantage of the public? This is unlikely since the percentage of the family food dollar he gets has been between 37 and 42 cents since 1957.

FARMER'S SHARE OF FOOD DOLLAR



Source: Marketing and Transportation Situation, February 1974.

Some may think the middleman takes more than his share. In individual cases this is possible, but there is evidence to

show that most processors and distributors of food products are not making excessive profits. Like many other businesses, some are having a difficult time competing on the market. One of the problems is the high labor cost. Of the total costs of moving food from the farmer to the housewife, labor gets an estimated 39 percent of the money. Workers in food industries and in transportation get a big share, but wages in these industries have not increased any more than other industries in our economy.

The results of research show that no one marketing group is taking advantage of the situation. The answers to the questions raised lie in the trend of the times. We want more services, changes in the price level, higher incomes, higher wage rates, increases in transportation costs, and higher marketing costs, for almost everything keeps the food bill high.

As consumers, we are partly responsible for higher marketing costs. More reliance on food canned in the factory instead of the home adds to the prices we pay. We also want smaller and better packages. We buy sugar in ten pound bags, rather than 100 pound sacks. It costs nearly as much to put a product in a smaller container as in a large one. Housewives also buy bread rather than the flour to make their own bread. They buy cake mixes and other partially prepared foods. What little flour they buy is often in a ten pound package. There is an increasing amount of ready-to-eat and ready-to-wear goods purchased by the

consumers. These trends help to explain the widening spread between farm prices and retail costs of food that result from more marketing services.

Several reasons are given for the increased demand for marketing services. One of the most important is the large number of women, especially married women, now employed outside the home. Families of working women buy more partially prepared or completely prepared foods. They also eat more meals in restaurants and other eating places. Many live in apartment houses where storage space is limited.

Another factor is that we have more money to spend and are spending more. We eat more expensive foods. We are willing to pay for the kind of service that improves the quality and attractiveness of the food we buy. These practices result in increased marketing costs.

The costs of some marketing services have been reduced. Self-service and prepackaging have replaced many retail store workers. Other technological advances have provided some additional services formerly not available. Thus the net marketing charge is a result of several changes which help us understand "what's happening in the dark" in terms of marketing costs.

Marketing costs may be too high because of too little competition. They may also be too high because of too much competition and duplication of services. Duplicating and over-

lapping of milk delivery routes are examples of inefficiency. Reports from many sections of our country indicate it is common to find eight to ten routes serving a small area. In some of the larger cities 10 to 15 trucks deliver milk on a single street. Most people will agree that competition is good. It gives an individual incentive. It encourages growth. It improves our standard of living, but it can also increase marketing costs if we have duplication of services.

Regardless of the justification for high marketing costs, as consumers we are paying higher prices than at any time since detailed records were kept. This is shown in the changes in the consumer price index which includes representative items for food, housing, clothing, transportation, and other things for which we spend our incomes. Using an average annual figure for 1967 and all items in the consumer index, the level of prices is much higher than what it was in the early 1930's. On the other hand, our incomes have also increased as shown in the comparisons of per capita disposable income over a period of years. The pressures are for incomes to increase when prices increase rapidly as they have in the past few months.

Year	1967=100 Consumer Price Index	Per Capita Disposable Income 1958 Prices
1933	38.8	$ 893
1960	88.7	1,883
1965	94.5	2,239
1970	116.3	2,610
1973	133.1	2,890

Source: Economic Report of the President, February 1974.

In the future it is possible that the prices of the things we buy will increase at a slower rate because of improved efficiency. In a competitive society, businessmen will be encouraged to adopt efficient practices and pass on at least part of the savings in the form of improved quality, better service, or a reduced price. On the other hand, as we want more and better services in the form of such things as attractive packages and partially prepared foods, we will have to pay for them. We must also consider the possiblity that inflation will continue to be a problem and food prices will increase at a rapid rate.

PART III

NATIONAL INCOME AND GROWTH

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Chapter 10

NATIONAL INCOME--MEANING AND MEASUREMENT

In the last three chapters we have studied the relationship of consumers, producers, and other individual groups in our society. Studying parts of the economy is referred to as microeconomics. As new tools of analysis were developed, it was apparent that we should give emphasis to the overall view of our economy (macroeconomics) in order to give better balance to the study of economics. The micro and macro approaches complement each other. We have a more complete picture of the functioning of the different parts when we also get an overview. In the next three chapters we shall study national income and growth by taking the whole economy and the macroeconomic approach.

Gross National Product--A Measure of our Progress

Total production or total output is measured by information published by the Office of Business Economics of the Department of Commerce to show the economic activity of the economy. The basic measures of this activity are gross national product, national income, personal income, and disposable income.

Gross national product (GNP) is the most frequently used measure. It is the sum of the market values of all goods and services produced within a given period of time. What are

final goods? We can consider them as products when they are sold to the final purchaser. What are services? Appliance repairing, beauty shops, medical, dental, and legal services are a few of them.

Gross national product is divided into four parts with various divisions and examples:

1. Personal consumption expenditures
   Durable goods--automobiles, homes
   Nondurable goods--food, clothing
   Services--transportation, communication

2. Private domestic investment
   New construction--homes, offices
   Producer durable equipment--machinery
   Changes in business inventories

3. Government purchases of goods and services
   Federal
   State
   Local

4. Net exports of goods and services--how much the value of our exports exceeds the value of our imports or vice versa.

GNP then is a sum of everything that consumers buy for their use (C), everything that business firms buy to use in their operations (I), everything that governments (local, state, and federal) purchase (G), and anything that foreign countries buy from our country over and above what they sell us. A general picture of our economy is often expressed as aggregate demand or C + I + G = GNP. The net export influence is usually less than 1 percent, but should be considered if we want an exact figure for GNP.

Personal Consumption Expenditures

Total spending of consumers now accounts for about 64 percent of GNP. The nondurable goods that are purchased are the most important group of items. Over a period of years, the proportion of consumers expenditures for services has been increasing. If the trend continues, the services will exceed the amount spent for the nondurable goods which has shown only a gradual increase. This is to be expected since we are dealing with the necessities of food and clothing.

The fluctuating part of personal consumption expenditures is with the durable goods such as automobiles and homes. The purchases of these items are more subject to business cycles. It is expected the consumer sector of the economy will contribute the most to the increase of total spending and growth.

Private Domestic Investment

Gross investment in our economy each year has varied considerably due to expectations of businessmen resulting from changing economic conditions. (The contribution to GNP from the I sector has averaged near 15 percent.) The value of building construction and that of producer durable equipment has been about the same for the past few years. The other item included in the investment figures of inventory changes varies over time. In the depression years, during World War II and the minor ad-

justment periods, inventories have decreased. We see rather wide fluctuations in inventories which is an indication of the health of the economy. When we get an inventory build-up, it is interpreted as a sign of overexpansion and the need for an adjustment in the economy.

Government Purchases of Goods and Services

We have experienced large increases in government spending. This is true for federal as well as state and local governments. During the World War II years, the federal government purchases of goods and services were very high. More recently, with the large demands for funds to develop local areas, the increase has been more rapid than that of the federal government. Expenditures of state and local governments now exceed that of the federal budget. Total government expenditures amount to about 20 percent of GNP. Except for wars, the expenditures have shown a gradual increase.

Net Exports of Goods and Services

The United States had a favorable balance of trade for many years. We exported more goods and services than we imported so we got a net export figure which we add to determine GNP. In the early 1970's we began importing more products than we exported so for the first time since the late 1800's, the United States had a minus export figure. This situation required some changes

in policies of not only trade but the balance of payments.

Comparison of Gross National Product

We measure our progress with comparisons of GNP figures over a period of time. Figures expressed in current dollars do not show actual growth rates so they must be corrected for changes in the value of the dollar. This can be done by using one year as a base. In the following chart, the growth in current dollars is shown, but the information has been corrected to show actual growth using 1958 prices as the base. When corrections are made for the value of the dollar, the rate of growth is more uniform and represents a more meaningful comparison.

An important aspect of the information analyzed, is that we have been able to lower unemployment only during the periods when our growth has exceeded 4 percent. For example, in 1962, when GNP increased by 6.6 percent, unemployment decreased. In the following years, when GNP was at 4 percent, the unemployment rate stabilized. For the past few years, as our growth in output has exceeded 4 percent, we have reduced unemployment. The reduction has not been consistent and there is a growing awareness among economists that an unemployment rate at 5 to 5 1/2 percent is more consistent with a stable inflation rate than the previous standard of 4 to 4 1/2 percent unemployment.

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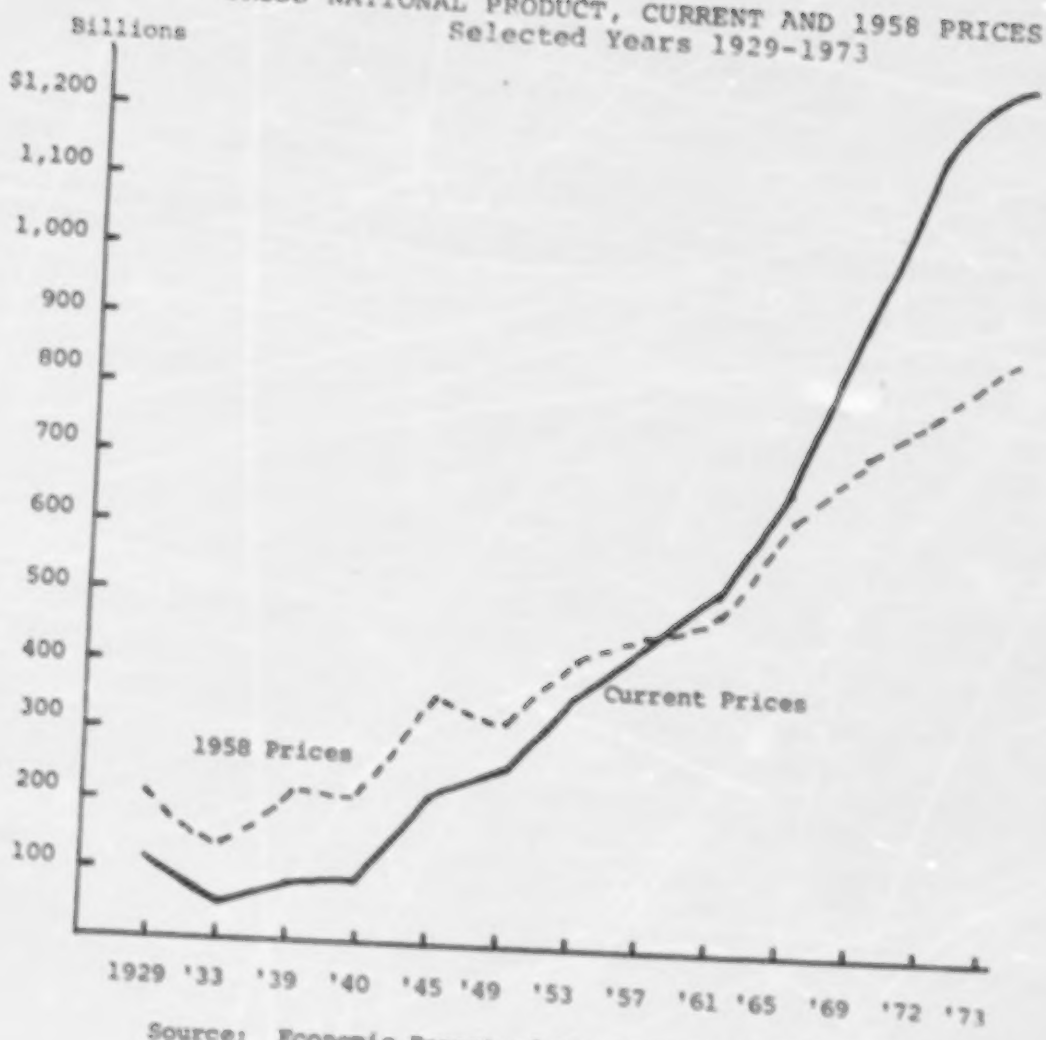
GROSS NATIONAL PRODUCT, CURRENT AND 1958 PRICES
Selected Years 1929-1973



Source: Economic Report of the President, 1974.

Gross National Product and National Income

We can measure our growth by computing GNP by the sum of payments made to the factors of production, land, labor, capital, and management. The total of the factor payments equals the income

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from rent of land, wages and salaries of labor, interest of capital and profit to the business. Rent + wages and salaries + profits will equal GNP (C + I + G) if we make allowances for depreciation, indirect business taxes and business transfer payments. In other words, we can compute total production in our economy from the product as well as the income point of view.

Gross national product then is one basis for comparing the economic health of every country. It is the best measure of our economic well-being but it has several shortcomings. It is quantitative rather than qualitative. Not all items are included in GNP because some goods and services are not exchanged in the market. Under these circumstances, an estimate has to be made of their value.

The Circular Flow of Income

One of the real advantages we have in studying the whole economy is that we can see how each change relates to all other changes. This is referred to as the circular flow of income and is illustrated in the diagram on the following page. We can follow the directional arrows to see the relationship of the different parts of economic activity. This information is published periodically in the Survey of Current Business, the Federal Reserve Bulletin, the Economic Indicators and other important publications.

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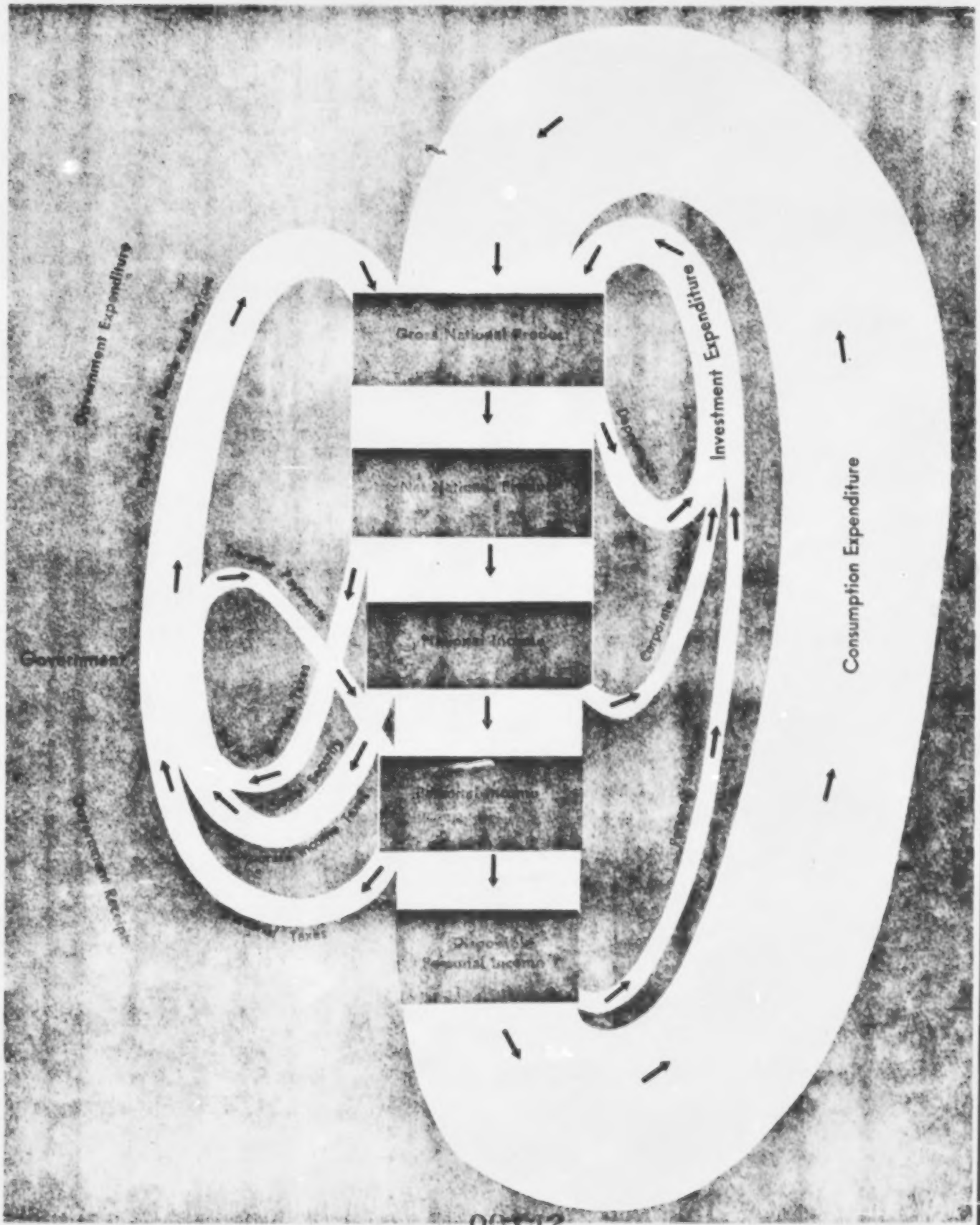
The Flow of Income and Expenditures in the American Economy



The chart is used to show business trends and job outlook. Identification can be made of signs of inflation or deflation and the factors that cause them. The chart provides data for policy decisions such as spending or tax changes. In general, it gives an overall view of economic activity that individuals, businesses, labor and government groups can use to make better decisions. There are interferences with the smooth circular flow. Sometimes the economy is speeded by consumers spending more, businesses increasing their investments or governments increasing spending.

We know that as consume[illegible]pend more money for goods and services that it takes more labor, capital, and land to produce these items. We say that the demand for capital goods is derived from the demand for consumer goods. If there is a greater demand for automobiles, there will be a greater demand for steel, rubber and the other things that are used in making automobiles. On the other hand, if people buy less cars and the supply appears to be larger than the number of automobiles manufacturers think they can sell, then they usually slow down the rate of production.

Proper balance in our economy gives the framework for rapid growth. We show this balance in the influence of consumers, business, and government groups. Often forecasts are made to show what we can expect. For example, the tax cut in 1964 of about $10 billion was estimated to increase gross national product by $24 billion, which would further increase consumption and stimulate investment so the combined effect would be an increased

spending of $37 billion.[1]

There have been several attempts by competent researchers to develop growth models. Rather complicated mathematical formulas have been used to analyze growth patterns and the business cycle. These models are in the process of being tested. There is not general agreement on the effectiveness of any one model, so it seems appropriate that we consider economic fluctuations and growth in a general way. We shall do this in the next two chapters.

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[1]The American Banks Association, Forecasting Business Conditions, 1965.

Chapter 11

FLUCTUATIONS IN PRODUCTION, EMPLOYMENT AND INCOME

We are interested in using our resources effectively, but unfortunately there are excessive wastes of natural resources and unused human resources. We try to keep these wastes as low as possible with conservation programs and policies to keep unemployment down. The intensity of these problems is greater in periods when we have depressions. What are the causes of wide fluctuations in economic activity? What are the indicators and how do we measure the changes in production, employment and income? How can we stabilize the economy? These are important questions that will be considered in this chapter.

The Problem of Instability

At the beginning of 1929 the forecasters predicted a good year. There was little unemployment. Production was at a high level. Business was prosperous. The stock market was booming. It appeared that our country was in fine shape.

By 1932 one-fourth of the working force couldn't find work. Many of those working were on a part-time basis. Industrial production was about 50 percent of what it was in 1929. National income had been cut in half. Mortgages were being foreclosed. The banking system was on the verge of collapse. Farm prices

were down 50 percent and evidence of the depression could be seen throughout the country.

It was a slow process to try to recover. Many felt that only time could solve the problem. Others wanted more positive actions with the federal government taking the lead in using programs to bring us out of the great depression. We learned many lessons but our progress was slow. It wasn't until after Pearl Harbor that we had work for all who wanted a job. During the period from the beginning of the depression to the end of the 1930's we had many unused resources. We were aware of the problem. We wanted to do something about it, but we had to study the causes and possible controls of these wide fluctuations in economic activity.

Causes of Fluctuations

What causes these extreme up and down swings? Writers in the early part of the century said the causes resulted from technological development. New methods, new products, and new procedures caused overexpansion and then underexpansion.

Later a group of economists suggested that controlling the money supply would cause less expansion and contraction. Savings and investment theories have also been suggested as causes of economic fluctuations. We shall consider monetary and fiscal policy as control features when we discuss stabilization, but there are some fundamental characteristics of our system we should identify.

The internal workings of the private enterprise system help to create instability. The profit motive, as important as it is to the success of our economy, causes over- and under-production if left free. If profits are high in an industry, businesses are attracted to the point that too much is produced, prices decrease, profit margins are lowered, businesses fail, production decreases and we get wide spread changes in economic activity.

The lack of mobility of labor is another factor. Labor is not easily transferred from one skill to another or one area to another. The same is true of land with the very fixity of location which limits its flexibility. Then too, some land has few alternative uses. The specialized wheat farmer in the Great Plains really doesn't have much of a choice in the use of his land if wheat prices are low.

Incomplete knowledge on the part of the worker of where he can get work, the businessman of what is best to produce and how much, the investor where to put his money to get the best results, contribute to fluctuation. The use of information and making adjustments would help reduce the fluctuations.

We shouldn't leave out the influence of pressure groups such as some labor organizations, a few businesses and other special interest groups. To the extent that adjustments are not favored and a positive program to encourage production is not used, then we get a slow down in the desirable use of our resources.

We are concerned with the dynamic nature of our economy. Technological change, automation and increases in population are only a few of the changes. If we know the causes and how to measure them, it appears a more likely possibility that we can solve the problem than if we assume that only time would make the necessary adjustments.

Measuring Changes In Our Economy

Historical facts and relationships are important to understand fluctuations in our economy even though no two cycles are the same. The most important key to understanding declines in production and employment is the fact that businessmen will not produce unless they can sell. Whenever a company finds the output piling up in unsold inventories, it cuts back production to the amounts its officials estimate can be sold. The possibility of selling at a profit is an important motivating force. But selling is impossible unless someone will buy. A general decline in sales throughout the economy is a drop in aggregate spending which is followed by cutbacks in production. This means smaller income in the hands of producers and further declines in spending, production and incomes.

On the other hand, increases in spending under conditions of less than full employment tend to stimulate production, increase the number of jobs and create more income. This sustains a further increase in spending, production, and income.

In our study we have referred to the overall changes in gross national product, employment, consumer prices, wholesale prices, and industrial production. We used the circular flow chart to show the relationship of different sectors of the economy. There are other indicators of a more specific nature that are used by different groups. Residential construction, for example, is a $30 billion a year industry. In studying the information on housing starts, we find that they moved counter-cyclical to the general business cycle during the recessions of 1948-49 and 1953-54. In the past few years they have not followed the same pattern. It is important for the builder to know what happens in residential construction throughout the country, but it is also important that he be aware of local supply conditions, incomes and the availability of financing.

Another indicator is plant and equipment expenditures. Since 1945 this information has been published by the Department of Commerce. It is one of a few statistical series in which estimates of anticipated events as well as historical events are made periodically. For example, an estimate is made six months in advance using reports of 2,500 corporations. One limitation is that businessmen do not always do what they say. The information does, however, serve as a useful guide.

Analyzing and measuring inflation is of interest to most people. Inflation occurs when the supply of goods and services does not increase as fast as the supply of money and demand for the things we buy. This relationship is expressed in the level

of resulting prices. We measure inflation by showing changes in the Consumer Price Index and the Wholesale Price Index published by the Department of Commerce.

The Consumer Price Index measures the changes in the cost of goods and services that the housewife pays every day. About 400 items, including products and services that range from a haircut to a new home, are priced by field investigators who visit stores and offices all over the country. The Consumer Price Index is a good guide but the Wholesale Price Index is a summary of what is actually going on throughout the entire business economy.

Other indicators published by the Department of Commerce are corporation profits after taxes, retail sales, manufacturer's sales, manufacturer's inventories, and balance of payments. The Department of Labor puts out information on the labor force, unemployment, average weekly hours and average hourly earnings. The total money supply, loans and investments, installment credit and industrial production information is published by the Federal Reserve Board of Governors. Private companies such as the F.W. Dodge Corporation and Standard & Poor's assemble information in Construction Contracts Index and Standard & Poor's Stock Index.

The wealth of information now available makes it possible to analyze with a degree of confidence most sectors of our economy. The ability to forecast is still an art, since the accuracy still depends primarily on the judgment of the forecaster. Judgment,

however, is improved when use is made of economy indicators. It is especially important for those who influence policy decisions about stabilizing the economy to have accurate information and to use it effectively.

Stabilizing the Economy

Fundamental in approaching the instability problem is a recognition of the complexity of our economic system. Numerous powerful forces are continuously operating, but with varying degrees of influence and under varying types of conditions. When these forces get out of balance, trouble is almost certain to result.

Comparing our economic system with an automobile may help to put us on guard against oversimplified solutions that ignore important causes. A car may stall simply because it is out of gasoline, in which case the obvious solution is to put in some gas. It may not run because the motor is flooded. The carburetor may be out of adjustment. Spark plugs may be broken or dirty. Even if the motor is functioning well, a broken drive shaft may prevent the power from getting to the wheels. The failure of any element critical in the operation of the car may slow it down or stop it altogether.

Although the economic system will not stop functioning entirely, there is trouble when any element vital to its functioning is impaired or when the forces get out of balance with each

other. We need to approach the problem of instability with the idea of making the repairs necessary to have a smoothly working machine.

Economic analysis tools give meaning to a great variety of information and experience. Systematic studies are being made of business cycles. We know we can measure income. We can quantify it so it is only logical to assume that methods can be used to influence fluctuations and possibly control them. These methods include monetary policy, fiscal policy, automatic stabilizers, and wage and price controls.

Monetary Policy

The Federal Reserve System has considerable influence on the money supply through control over the Federal Reserve interest rates, open market operations and reserve requirements. The action of the Board of Governors through the banks is considered a major factor in influencing economic activity.

Federal Reserve Bank Interest Rates. Federal Reserve banks lend money to member banks, either on the notes of the borrowing banks secured by the notes of private borrowers held by the banks or by buying notes from the banks. The Reserve Bank charges a fee for this service similar to the interest charged by member banks on loans to customers, The higher the price or interest rate, the more expensive it is for the banks to borrow. The banks then raise the rate to customers, which discourages borrowing. A rise in the

rate is interpreted as an indication that the Reserve Bank feels that some tightening of lending policy is needed. A lowering of the rate is a sign that credit will be easier providing enough of a change is made to encourage borrowing. Changes made in the rates over the past 20 years have varied from as low as 1 and 1/2 percent to a high of 8 percent. In some years, changes are made rather frequently to try to stabilize the economy.

From the point of view of the borrower, an increase in the rate usually means credit will be higher. For example, a family interested in buying a home may hesitate to make the decision if interest is raised from 7 1/2 to 8 percent as a result of the Federal Reserve raising its interest rate from 5 1/2 to 6 percent. On a $20,000 loan over a 30-year period, the family would have to pay about $3,500 more in interest if the rate were increased by one-half of one percent.

Open Market Operations. Buying and selling of government bonds by the Federal Reserve is used to stabilize the economy. When the Reserve System sells bonds, money is taken out of circulation. When it buys bonds, the money supply is increased since the bank or person who sold them now has more money. The seller of bonds usually deposits the money in his bank, increasing the total deposits of the bank and the bank in turn can increase its reserve account. The amount of increase

will depend on the reserve requirements. Bond selling campaigns are used to take money out of circulation. This is usually done when there is inflation.

There are some who feel that open market operations are the most important influence on our money supply, even though we hear or read very little about these transactions. An Open Market Committee, composed of the seven members of the Board of Governors, the President of the Federal Reserve Bank of New York and Presidents of four other reserve banks who serve one term in rotation, makes the decisions on when to buy and to sell. This rotation process makes it possible for all reserve banks to be represented in a period of three years.

Reserve Requirements. Member banks are required by law to keep a certain percentage of their demand deposits and time deposits in the accounts of the Federal Reserve district banks. The range of these requirements is set by Congress, but the Board of Governors can vary them within the limits. The basic idea is to raise the requirements when we have inflation and the amount of money needs to be reduced, and to lower the requirements when it appears desirable to increase the money supply. The higher the requirements, the less money the bank has to loan; and the lower the requirements, the more money banks can loan. The requirements for both demand and time deposits for the city and country reserve

banks are shown as follows:

RESERVE REQUIREMENTS FOR BANKS

	Range	Requirements--Demand Deposits Effective Rates	
	Present Legal Requirements	Under 5 million	Over 5 million
Demand Deposits			
Reserve City Banks	10-22%	17%	17 1/2%
Country Banks	7-14%	12 1/2%	13%
Time Deposits			
Reserve City Banks	3-10%	3%	5%
Country Banks	3-10%	3%	5%

Source: Federal Reserve Bulletin, March 1974.

Relatively few changes are made in reserve requirements; but when the action is taken, it is reflected quickly in the economy. The stock market is especially sensitive to these changes. This causes some to maintain that reserve requirements are more important than interest rates and open market operations as an instrument of monetary policy.

The question is often raised as to whether the Federal Reserve Board of Governors has too much power in view of the Employment Act of 1946 which makes it clear that the President is responsible to stabilize the economy. The Board does act independently, and it is important that the actions in monetary policy are coordinated with fiscal policy decisions. We must recognize too that private investment is one of the most diffi-

cult to control. The very nature of technical progress causes private investment to occur in spurts. It is generally accepted that monetary policy is more effective in curbing a boom than in helping to bring the economy out of a depression.

Fiscal Policy

If fluctuation in private investment is a cause of instability in production, then it can be offset by government spending in such a way as to compensate for it. By increasing government spending when private investment declines and decreasing it when private investment becomes large enough to generate inflation, stability is achieved most effectively, some people argue.

Another way to approach the problem would be for the federal government to decrease its taxes during depression periods in order to leave more purchasing power in the hands of private spenders, then reverse the tax policy in prosperity. If each extra dollar were spent in depression either by government or private spender, there would be a multiplying effect of about three times the original spending; so it is argued that the overall increase in production, income, and employment is well worth the deficit incurred.

There are some economists and government leaders who think fiscal policy of spending and taxing can be used effectively to keep our economy in balance. Most would recognize, however, that it is not a cure for all types of unemployment or for

problems in individual businesses. The types of projects used to increase government spending often do not create jobs for the people who need them. Then too, the effects of fiscal policy can easily be offset by rising wage rates, monetary policy, and international situations.

Automatic Stabilizers

Referring again to 1929, when the outlook for the economy appeared to be good and yet we had the resulting depression in the early 1930's, we can see why it is often stated that we are due for another depression. There are characteristics of certain periods that seem similar; but our economy operates with a graduated income tax, unemployment compensation, social security, insured bank deposits, minimum wages, price supports, and long term commitments on mortgages. These have an automatic influence toward stabilization even to the point that some writers feel they are the most important contributors to a stable economy.

One of the most important automatic stabilizers is the graduated income tax. In prosperity high incomes are subject to high tax rates, thereby taking purchasing power out of the market. In depressions, the lower incomes are taxed at lower rates and with the exemptions, a larger proportion of income remains for spending.

Try to put yourself in the position of living in 1929. If you had money in a bank there was no insurance as to its

safety. Now each deposit is insured by the Federal Deposit Insurance Corporation up to $20,000. Coverage for unemployment is now available. It wasn't in 1929. You have protection for survivors and retirement benefits under social security, but this has only existed since 1935. Wages were not protected in 1929. We have minimum wages now. Agriculture experienced a decline of 50 percent in prices. Use of price supports have tended to stabilize prices. We can get a mortgage on a home now for a 35-year period. Mortgages used to be written for three to five years. To buy stock in 1929, one only had to have 15 percent cash and was given credit for 85 percent. The margin requirements have been much higher since 1929. Since 1945, they have never been lower than 50 percent.

Wage and Price Controls

Usually we consider controls of wages and prices as an emergency measure in wartime to keep prices from going too high. When we divert our resources to the war demand from regular production patterns, the supply of many consumer items is reduced, thus creating a pressure on prices. The general problem is consumer income stability and the relationship to inflationary pressures.

We do have pressures for wage rate increases other than war emergencies. Unions as representatives of workers often press for wage increases more than the response we get from increased demand. Wages in our economy, it is argued, are not as much market-determined as administered prices. Wages

may rise in response to economic conditions, but they do not fall when unemployment increases. The resistance of wage reductions comes from fear that once they go down they will be hard to get back up.

Wage guidelines have been suggested as a policy for management and labor to follow. The idea of increasing wages no more than 3.2 percent per year has not been effective. It appears that wage policy as a stabilizing influence has limited possibilities except in cases of fixing wage rates.

Changes in wage rates certainly have an influence on prices. As costs increase the pressure is for prices to increase; but are prices pushed up by wage increases or are wages simply following prices upward in a spiral of creeping inflation caused by other factors? This question is not easily answered. We do know that like wages, price changes downward are resisted by trade associations and other groups. Wholesale food prices fluctuate more than industrial prices. The policy of full employment encourages inflation. Full employment and price stability may not be compatible with policy objectives. Full employment policy, some claim, will lead to a steady rise in wages and prices. The inflationary pressure became so great in the early 1970's that wage and price controls were introduced in various phases. Phase I set up the machinery for Phase II and the actual controls, which lasted until January 1973 when Phase III and a voluntary control program was introduced. This program lasted until July

1973 to ease into Phase IV and eventual termination of price and wage controls on May 1, 1974. Controls were very ineffective as far as controlling inflation was concerned. The rate of inflation increased from 2.0 percent in Phase I to 3.6 percent in Phase II to 7.4 percent in Phase III and 12.3 percent in Phase IV.[1]

Policy Suggestions to Encourage Stability

With persistent inflationary pressures, we might consider some suggestions to encourage more reasonable price stability. These suggestions are not new, but they might be justified if we are sincere about controlling economic fluctuations.

1. Representatives of labor, business, and government should meet often to coordinate their policy decisions.
2. There should be a closer working relationship between the Federal Reserve Board of Governors and the President's Council of Economic Advisors to coordinate monetary and fiscal policy decisions.
3. Have the goals of price stability written into the Employment Act of 1946.
4. Use the President's Economic Report as a more effective instrument for bringing pressure to bear on private wage and price decisions.
5. More rigid enforcement of the anti-trust laws.
6. Use a more liberal tariff policy.

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[1] U.S. News & World Report, May 6, 1974.

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7. Encourage labor unions to improve labor mobility, increase labor productivity, and reduce restrictive labor practices.

8. Rely more on research and education to get a better understanding of the different groups concerning the stability problem.

Stability Goals

Many suggestions have been made over the past few years on what our goals should be in regard to unemployment, price stability and growth rates. Some say that if we want to have full employment and high growth rates we cannot expect price stability.

Unemployment rates seem reasonable if not in excess of 5 percent of the labor force. This allows for changing jobs and adjustments that normally take place.

Wholesale commodity prices as an indicator of business conditions did not change very much from 1957 to 1964. Those in favor of price stability looked at this as a favorable period. Beginning in 1965, however, we had a more rapid increase in wholesale prices and at a rate that is considered excessive if we are to control inflation. The level of consumer prices has increased each year since 1955. The increase has been more rapid since 1966 and especially in the 1970's.

With these developments, what stability goals seem to suggest an appropriate balance of unemployment, price level change, and rate of growth? An unemployment rate of 5 percent,

a price level increase of about 4 percent, and a growth rate of approximately 4 percent a year are viewed as desirable goals over a long period. We will have a better understanding of the the possibilities after we have considered how our economy has performed over a period of years.

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Chapter 12

HOW OUR ECONOMY HAS PERFORMED

We have a lot of evidence to show that our economic system has been successful. By most economic measures there are results to show our progress. Comparisons are often made for economic quality, productivity, and growth to evaluate how our economy has performed.

Economic Equality

In a market oriented economy we usually share the benefits of our progress in proportion to our contribution. We have the right to choose our occupation and to own property. We decide how to spend our incomes. We have the chance to make a large number of choices with different alternatives.

There are some restrictions. Government has placed regulations on some occupations such as gambling and producing and selling harmful products. Zoning ordinances limit individual decisions. Trade unions sometimes set standards and requirements which may keep a person from entering the occupation he prefers.

Our ability to gain economic equality is influenced by our income. We have made some improvements in getting a more equal distribution of income as was shown in Chapter 7. Fewer of our people are in the low income groups. More are in the higher income groups.

There is evidence of economic inequality in some parts of the U.S. that are often described as poverty areas. These inequalities create difficult problems, many of which are hard to solve. Some of these will be discussed in Chapter 15.

With some exceptions, we could rate ourselves as improving in economic equality. Some of the other countries have a more equal distribution of income than we do because government provides many of the services that we make available through private enterprise. In some cases this is an advantage, but our primary concern is that we don't get carried away with economic equality to the point that the benefits we receive individually are not in proportion to our contribution. Differences in wage rates and salaries are essential incentives to encourage efficiency and greater production.

Productivity

The advances we have made are reflected in the output of our resources. A skilled worker is usually more productive than an unskilled worker with equal capital resources. Increased productivity per person is the key to our economic achievement. The average worker today with improved machinery and better working conditions is producing much more per hour than he was a few years ago. This high productivity allows for higher wages, shorter hours, more leisure, and greater profits.

The Advantage We Have

Our variety of natural resources have contributed to our ability to produce. Vast areas of fertile soil, favorable climate conditions and the use of scientific methods have made it possible to achieve higher standards of living. With 7 percent of the world's land area and about 6 percent of the population, we produce approximately one-third of the world's output of goods and services. Factory productions amount to about half of that produced by all other countries. Production of many varied and diversified products gives us conveniences which are not found in other nations.

Indexes of total output, employment, and output per man-hour for the whole economy show gradual increases over a period of the past three decades. Our ability to produce is reflected in the more rapid increase in output and output per man-hour in comparison to employment.

In agriculture, with the use of modern methods, output per man-hour has been especially good so that the number employed decreased and we still increased output. The unusually rapid increase in output per man-hour illustrates the progress in this important basic industry.

Total production in the United States is about three times as high as it was in the boom year 1929. During the past few decades output per man-hour has increased about 2.5 percent a year for the entire economy. There have been years in which we have been more efficient than others, but the

general trend has been toward greater productivity in the use of our resources. It may help to analyze how we get increased productivity, but also to consider some of our production problems.

How We Get Increased Productivity

The reasons for our increased productivity are associated with the characteristics of our economy. Private enterprise and personal incentives encourage us to work hard, increase our skills and use better management methods. We have more and better capital equipment and mechanized power. We have made advances in science and technology. One measure of our increased productivity is industrial production. In the past twenty years, industrial production has increased over 50 percent.

Productivity could be increased even more if we fully used our resources. Over a period of years our factories have been operating at less than capacity. The percentage of factory output to capacity has been about 85 percent since 1950. It was down to about 72 percent in 1957-58 and for selected industries it was very low in this period. If we produce at 91 percent as we did in 1966, it is considered an acceptable goal to reach.

Work stoppages which include all strikes are considered a problem in our economy. This is especially true when key industries and those that supply services that depend on

others are involved. Prolonged strikes can result in losses of productivity and unused resources. Actually the man-hours lost through strike over a period of years have been a fraction of a percent of the total days worked.

We have made gains in another way as far as workers are concerned. The length of the average work week has been reduced from 60 hours at the turn of the century to less than 40 now. In 1850 it was 70, so we have made some progress.

Stability

It is possible to have better and fuller use of resources if we avoid depression and inflation. A growing economy that aspires to give consumers and producers considerable freedom may have some ups and downs in activity that are not desirable. Both depressions and inflation have been problems. Since World War II inflation has been a problem, except for short periods of time.

Value of the Dollar and Inflation

The value of the dollar has decreased by any measure we want to use. The Bureau of Labor Statistics in the Department of Labor reports information based on the consumers price index and wholesale prices. In the past twenty years, the value of the dollar has been reduced by over half. The greatest losses come in periods of rapidly increased prices.

Inflation has been the dominant trend through this century with the exception of the depression years of the 1930's. In the past, the forces of inflation have been fed by war and pressures of wage rate increases.

With inflation, the purchasing power of the dollar decreases. We are interested in having our incomes increase to more than offset the changes in the value of the dollar.

Inflation creates problems for those on fixed incomes. With higher prices and no change in income, less can be purchased. Inflation is sometimes called the "most unfair tax of all" because it decreases real incomes that already lag behind the average increases in prices and aids those whose incomes rise faster than the average level of prices.

Government Action and Inflation

Inflation in the United States has created problems, but they have been small compared to some other countries of the world. The business cycle and its ups and downs is another problem of capitalism. To solve the problems of depressions and recessions, the government has introduced into the economy different stabilizers and policies.

The automatic stabilizers have been used effectively to help prevent large fluctuation in economic activity. A graduated income tax is important because as a recession develops less is paid in taxes and proportionally more income is available for spending by individuals. Unemployment compensation operates as a stabilizer. When people are out of work, they receive some incore

to spend. Price supports and social security benefits also act as automatic stabilizers.

A strong monetary policy is an essential part of a stable economy. The supply of money is influenced by the discount rates that the Federal Reserve Bank charges its member banks. The banking system is also influenced by the Federal Reserve System which uses open market operations or changes reserve requirements. Credit controls are used when necessary to encourage or discourage buying. Money deposited in most banks and savings and loan associations is insured up to $20,000 by the Federal Deposit Insurance Corporation or the Savings and Loan Insurance Corporation. All of these help stability.

Fiscal policy has been used to stabilize the economy. An example is the Revenue Act of 1964 which reduced income tax rates paid by individuals and corporations. Reductions in taxes are always welcomed by taxpayers, but the real purpose of the tax cut was one of a continuing series of adjustments made by the Federal Government to control the overall level of economic activity. The tax reduction proved out in practice since the lowering of taxes increased the available money for spending and served to stimulate the economy.

There are wide differences of opinion even among professional economists as to whether fiscal policy or monetary policy provides the best means of controlling cycles. Most agree, however, that

the automatic stabilizers have served a useful function in the stability we have had since World War II. As is the case in most countries, economic stability is not easy to maintain and the United States is no exception.

Government Debt--Is It a Problem?

In addition to inflation and rising prices, many are concerned about large debts, particularly government debt. Rising debt is looked on with mixed feelings. Historically there is a good reason to be concerned, because debt was almost a sure sign of panic or depression. In the early part of the century a debt-free home was a virtue. Life insurance was just getting started. Pension funds were not available. The rich were the only ones who bought stocks and bonds. Paying off the home mortgage under these conditions made good sense and this may still be true today. But whether it is true or not, many Americans no longer believe it to be, and having a mortgage appears to be no disgrace or handicap. There is a change in attitude toward both private and public debt.

Total debt has been increasing rapidly, but the largest increase is in private debt compared to debts of the local, state, and federal governments. This is not to justify the one or the other because there is more to debt than the large numbers. Federal debt has helped to win a war, corporate debt has provided factories and products to stimulate the economy,

and consumer debt has provided a bigger immediate market for products.

In the minds of many, debt is an economic problem. But debt itself is neither good nor bad, it is the use of debt that is all important. So long as debt is used constructively and productively, it can be a major force in economic progress.

Even the attitudes toward debt affect the economy. When we think debt has weakened the economy, we may be reluctant to risk our fortunes in new areas. If we feel too secure, we may spend more than our income will allow.

Another important aspect of debt to consider is the fact that, relative to other debts (incomes of the economy, and production of goods and services), our federal debt today is considerably more modest than it was 15 years ago. The ability of any individual to carry debt increases with a higher rate of economic growth and the resulting increase in incomes, and so it is with the government. The ability of the nation to carry debt has increased as a result of our increased production (GNP). The federal debt as a percentage of the Gross National Product is actually decreasing while the private debt is increasing percentagewise. This has been happening since about 1950.

The problem of large consumer debt, used primarily for consumption rather than acquiring things to improve earning power of individuals, is a problem. Over the past several years the amount of debt extended has exceeded that repaid. Outstanding consumer debt has grown gradually since the 1950's.

When we consider the federal debt separately from other public debt, we get some interesting comparisons. The big increase in federal debt came about during World War II when about $200 billion was added to the debt in a period of five years. Since then we have had a gradual increase, with the exception of the recent pressures of war when again we have had large expenditures. This is alarming to many, but as a percentage of our ability to produce, debt is actually decreasing. In 1946, for example, the federal debt was higher than GNP by nearly 50 percent. In 1973 it was less than one half of GNP.

Who actually finances the debt? The direct owners of government securities are individuals or institutions who have transferred a part of their spending power to the federal government by buying bonds. This group of creditors has loaned money to the government similar to those who buy corporate bonds to expand a business. About 95 percent of the interest payments on government bonds goes to individuals or groups in our country. The other 5 percent goes outside the United States. Now, who owns the debt? Actually financial institutions, corporations, and state and local governments are more important holders

than individuals, as it is sometimes assumed.

Can wise management of the debt contribute to economic stability? The Federal Government can borrow from the public when it wants to influence private spending. Especially in wartime, the government wants to divert some of the resources from production of consumer goods to war goods so it asks the public to buy bonds to help the war effort. Such was the policy in World War II. On the other hand, we tried to spend our way out of the depression in the 1930's but we still had about 8 million people out of work in 1940. Business recovery from the depression seems to have taken place despite rather than because of anything the government contributed.

Empirical data show, however, that the rise in GNP is at a more rapid rate during the years when the government is running a deficit than when it has a surplus. The wartime experience also shows the powerful stimulus that government can be to the economy. Deficit spending can be stimulating to the economy with unused labor and other resources.

Individually and as a group we have to meet obligations as they become due. As long as we continue to meet our obligations regularly and as long as we have the resources to draw upon to make certain that we can meet them, debt may not be a problem. If, on the other hand, we have excess debt and other parts of the economy are not functioning properly, the combined effect

can cause economic problems and slow down our growth rate.

Growth

Growth is a measure of production efficiency and is often computed by showing the production increase from year to year. We show our growth rate in gross national product, which measures the contributions of consumers, businesses and government groups.

Measuring Our Growth

Over a period of years our rate of growth has varied considerably. By using 1958 prices, we can show the actual growth from year to year. Some years such as those of 1931, 1932, and 1933, gross national product decreased. In the period immediately following the great depression, the growth was rather slow but gradual. In other periods we have had substantial increases in our production.

Our growth is measured in other ways, but they show parts of the economy. Some like to think of growth as numbers of people and particularly the labor force as a potential productive force. Others relate growth to increase in personal income or gains in retail sales; but the overall growth must include the whole economy. Gross national product is the best measure we have at the present time.

Growth in Selected Countries

Comparisons of GNP can be made for different countries. Comparisons are most meaningful if made on a per capita basis using the same monetary unit such as U.S. dollars. The productive capacity of the United States economy is greater than the other advanced free world countries and much greater than the Communist countries.

Most people are impressed with our overall progress and our ability to produce. We are constantly making adjustments in the rapidly changing world. Our ability to continue to grow and develop will depend on how well we make decisions as workers, businessmen, leaders, or policy makers.

An Overall Rating

It is evident that the U.S. would rate high compared to other countries on equality, productivity, stability, and growth. Any measure of efficiency would show how well our economy has performed. There have been times, however, when unemployment has been high. We have not been careful in using our resources, so we have an energy crisis. We have had inflation at a more rapid rate than we think is desirable. Our growth rates have been less in some years than we would like to have had them.

Population has grown at a more modest rate than our ability to produce. There has been an upward trend in real wage rates.

The share of wages and salaries relative to returns on property has shown considerable consistency. The ratio of investment to income has been growing. We have had more prosperity, but more debt too. Borrowing has now become a way of life. We have problems in the cities as well as the changing countryside of abandoned farm houses and ghost towns. Our role in world leadership has been challenged.

Even with the problems and adjustments in our economy, the overall production has been reasonably good. Because of our ability to produce in the future, we will probably be called on to continue to aid others, especially the underdeveloped countries. Our relationship with other countries will be considered in the next chapter.

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PART IV

THE WORLD ECONOMY

Chapter 13

THE UNITED STATES AND THE WORLD ECONOMY

Why should the United States be concerned with other countries of the world? We have enough internal problems. We do not have to depend on other countries for many of the goods we import. We could trade for a few selected products, and produce everything else in our country.

We have heard statements of this type and have agreed to a certain extent, but the policy we have is one of being involved in world activities. We have taken a stand to support and protect freedom through military and civilian aids and services to other countries. We depend on trade for resources and markets which we need to expand our economy. And finally, it is claimed that associating with other countries tends to create a good neighbor attitude of friendliness and peace rather than suspicion and mistrust.

Why Is Trade Necessary to Stimulate U.S. Growth?

All nations have distinct natural resources, special skills and "knowhow," different soils and climates, and differing political and social attitudes. Some nations have an advantage over others because of natural resources. For example, the United States has the capacity to produce cheaply great quantities of cotton. Brazil has a disadvantage in producing cotton because of

the climate, but they do have the advantage in producing coffee. Because we cannot produce coffee economically, we find it an advantage to trade with them. The economic welfare of countries is served best when the people specialize and then trade instead of trying to be self-sufficient.

How Important Is Foreign Trade

Even though we have a variety of resources and would not have to depend on others very much, we have a greater volume of foreign trade than any other nation in the world. Trading with other countries contributes to our growth. Imported raw materials aid in increasing production. Foreign trade accounts for about four million jobs in our country. It provides a market for nearly 17 percent of the total farm production. There is a market for industrial products. We depend on other nations for trade that is vital to our continued growth.

With Whom Do We Trade

Traditionally, Europe has been an important market for our exports as well as a source of imports. Other markets are in Asia, Canada and more recently in some of the Communist countries.

Our activities with other countries involve more than the exchange of merchandise. Later we shall consider other things such as the influence of tourist expenditures, transportation, investment abroad and military expenditures. When all of these

and others are studied later in the chapter we will be concerned with the balance of payments and its associated problems.

Multilateral Trade

It isn't likely that any two countries will exchange exactly the same value of goods in any given period of time. If trade takes place among three or more countries, no one country will need to balance out its account with every other country.

Suppose Country A sold Country B $45 million worth of cotton, but did not buy any goods from Country B. Country A did buy $45 million worth of tin from Country C. Country C, in turn, purchased $45 million worth of machinery from Country B. The purchases of all three countries then balance. This operation illustrates what happens on a broad scale among all trading nations.

In actual practice, countries rarely barter one commodity for another. Businessmen in different countries often trade with people they will never meet. Each has to have confidence in the other. Countries also have different monetary systems so some method must be developed to finance trading.

Financing Foreign Trade

Let's assume a businessman in the United States wants to buy bananas from a firm in Nicaragua. Our businessman gets a

letter of credit from his bank which is a commitment on the part of the bank to pay a specified sum for any merchandise shipped to the importer. The businessman sends the letter of credit with his order to Nicaragua specifying the quantity, quality, price, exchange rate of money, and conditions of delivery for the bananas he wishes to buy.

The banana dealer in Nicaragua agrees to fill the order because he wants to sell his product, and he is sure he will be paid because of a letter of credit supported by an American bank. He ships the bananas and fills out a bill of lading which is a receipt for the goods he has put on the ship. The transporting company delivers the bananas. A bill of exchange (similar to a check) is sent from our businessman's bank to the bank of the banana dealer for the payment. The amount is deducted from the businessman's account and the banana dealer is credited with the payment in his bank in the money used by his country. The process is similar to clearing a check in the United States that we discussed in Chapter 5.

Trading in foreign markets requires a great deal of planning and coordinating among various groups. We sometimes try to control trade and in so doing often create problems. There are some justifications for influencing trade.

Why and How Trade Is Controlled

Nations attempt to control world trade to protect domestic industries against foreign competition or to improve their own

position. There are several ways this can be done:

1. Use of a tariff which is an import tax to raise the price of imported goods.

2. An import license or quota which gives permission to import only a certain amount.

3. Regulation of exchange rates between countries.

4. Subsidizing exports so our products can compete at lower price levels in other countries.

5. Political barriers also interfere with trade.

Our Trade Policy

Since the Constitution was drawn up, men have argued for either high or low tariffs as the economic trade policies. Many people wanted to protect the United States by high tariffs, and others argued that low tariffs are best. The following summary gives arguments for both sides:

Protective Tariffs Would

In Favor of Tariff	Anti-Tariff
1. Promote national unity and independence.	1. Mean a narrow outlook and hinder a high degree of economic achievement.
2. Encourage home markets which are more reliable and of constant demand than foreign markets.	2. Tend to lower standards of living and eventually exports because the value of exports and imports should be balanced in the long run.
3. Promote self-sustenance during a war when you don't need to depend on trade.	3. Cause a protection attitude.

4. Help domestic industries acquire strength and momentum.	4. Cause protection industries to delay growth.
5. Provide defense against dumping. (Sale of products in another country at a lower price than the cost of production just to get rid of surplus.)	5. Eliminate export dumping.
6. Protect labor against low foreign wages.	6. Discourage technological development.
7. Provide tax revenue.	7. Defeat their own purpose. High tariffs cause lestrade and therefore less tax.

Today the U.S. trade policy is in general one of no or low tariffs, and trade agreements. Countries negotiate with each other for an adjustment of tariff rates on various products for their mutual advantage. For example, Canada made an agreement with the U.S. that if we would lower tariffs on their machinery, they would lower tariffs on U.S. automobiles. The agreement was beneficial to all.

In 1947 at Geneva, Switzerland, 23 countries met to discuss reduction of trade barriers on a broad scale. This conference ended in a general reciprocal reduction of tariffs. By 1964, 62 nations agreed to comply with the General Agreement on Tariffs and Trade (G.A.T.T.). This trade agreement has done much to increase world trade and make it more effective.

Recognizing the importance of trade, Congress enacted the Trade Expansion Act of 1962. The President under this act has

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new authority to enter into trade agreements. He is authorized to enter into a trade agreement reducing duties with any other country by 50 percent. He can reduce or eliminate duties on products which are not produced in significant quantities in the United States. He is permitted to eliminate tariffs on products where the duty is 5 percent or less. There are restrictions on how rapidly reductions can be made. In most cases these changes must be made no more rapidly than in five equal annual stages.

An additional advantage of the act is that it contains provisions to strengthen the hand of the President in dealing with unjustifiable and unreasonable foreign import restrictions. The act also provides careful safeguards to insure that the interests of all segments of our economy are considered. Public notice and public hearings are provided in advance to permit all views to be presented. Different departments of the government are encouraged to work closely together to help make the act work effectively.

Our Balance of Payments Problem

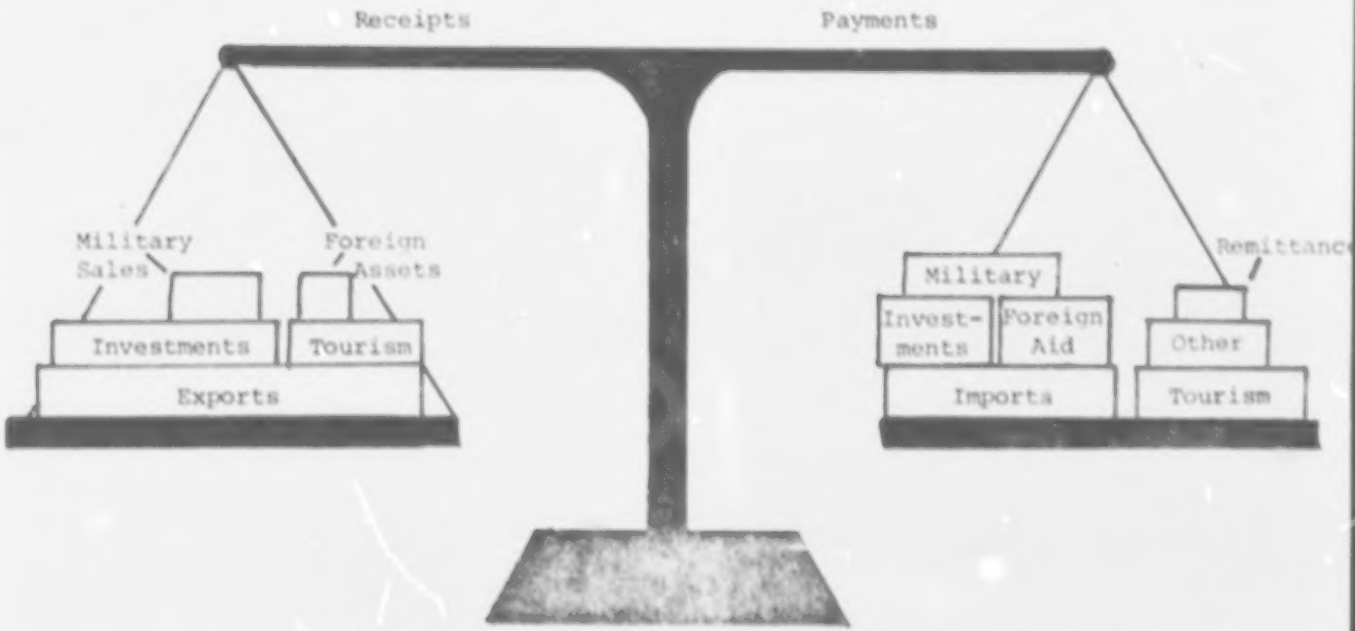
Our exports in most years have exceeded our imports, so we have had a favorable balance of trade. This is called a trade surplus and can be illustrated this way:

BEST COPY AVAILABLE

EXPORT-IMPORT BALANCE

Trading in merchandise is only part of our total foreign transactions. The trade surplus is more than compensated for because of our spending abroad for military and foreign aid, tourists, and private investors making a balance of payments as shown in the following chart:

BALANCE OF PAYMENTS



In most years since 1950 we have had to balance the payments with claims against our gold supply or the making of loans. When the claims against our gold became large, the emphasis was placed on making loans to balance the payments each year.

We are all interested in a strong dollar. If we consider U.S. investment abroad and the value of loans that have been made to foreign countries, the dollar is not as weak as it may appear. For example, in 1970 United States investment abroad was $166.1 billion and foreign investment in the United States was $94.4 billion. Thus, there were $69.7 billion more U.S. invested dollars in foreign countries than there were of foreign dollars invested in the United States.

We need to consider what financial aid we can reasonably give to other countries. If we could reduce spending abroad through adjustments in various government activities, we could have a more favorable financial relationship with other countries.

The balance of payments problem is considered very important. Proposals have been made to help solve the problem. A few of the things that have been suggested are:

1. Encourage tourists to travel in our country and reduce the duty free allowance of tourists to $50.
2. Discourage loans abroad. Tax U.S. bank loans to foreign borrowers for periods as short as one year.
3. Control direct investments abroad.

4. Give foreigners a tax incentive to invest in the United States.

5. Step up the United States' campaign to promote exports.

6. Cut United States Government spending of dollars abroad to the limit.

7. Reduce inflation in the United States to encourage more exports and fewer imports.

Even though the first five items are important, it appears that the last two might be emphasized as a long-term goal. Hundreds of billions of dollars in economic and military aid have been made available to foreign countries. Europe has received more than any other area, but the Far East is getting more attention now. Many programs have been worthwhile, but many have had questions about the effectiveness of our overall foreign policy.

An Overview

Trade is carried on between countries for the same reasons it is carried on within countries. It permits a high degree of specialization and can result in increased output. We can benefit by getting more and cheaper goods.

Payments are made between nations not only for commodities, but also for services, gifts, loans, direct investments, and tourist trade. In making payments the money exchange, unless set by governments, depends on foreign money arising out of payments for imports of goods and the use of services. Supply of foreign money arises from the opposite types of transactions including exports.

Trade among countries has been beneficial. Much progress has been made in our country to encourage trade with others, especially in the free world. Some think of trade as desirable as long as it is not with the Communist countries. Others, thinking of the benefits of trading, think it would be best to have more trade with Russia and Red China. We will probably have a more realistic opinion after we have studied different economic systems.

Chapter 14

COMPARATIVE ECONOMIC SYSTEMS

Most of the people in our country are satisfied with our economic system and some hesitate to use valuable time studying about other systems. We may think that other countries have little to offer to improve our system. The security, stability, and freedom we enjoy seem to be lacking in countries that have socialism and communism.

It is usually of interest, however, to read about how men conduct their economic affairs in different places. How do they decide what to produce? How do they distribute their income? How do they provide for security and stability? How do we account for their rapid growth? What part does the individual or family play in their society? These are interesting questions we can understand if we look at features of different systems.

How Can We Compare Systems?

It is apparent that economic goals of different peoples and nations play an important role in the political and social order they wish to maintain. We may claim our progress can be explained by profit motives, private property, and individual incentive. The Communists are convinced that capitalism, as they understand it, corrupts individuals, leads to business

cycles and unemployment. They claim rapid growth comes through government planning. The methods are different, but is it possible that the economic goals or objectives could be similar? The leaders of both of these systems are interested in using their limited resources to satisfy as many wants as they can. Each system performs similar activities in producing and distributing to provide for the needs of the people. Every economy wants to provide at least a minimum of goods and services. Decisions must be made on the things to be produced. Each tries to employ the most efficient methods. Output levels are increased if people are doing the things in which they can be most productive. The chances for progress are improved if people can share in the national income in proportion to their contribution.

These statements would seem reasonable to most people in different countries. But we do not agree on the policies and methods to get the job done. In a capitalistic society most businesses are privately owned, the system responds to the demands of the consumers, and the political setting is usually a democratic representative government. Central planning in contrast operates under political supervision, power, and authority. The government owns, operates, and plans the decisions which are not subject to democratic revision or change. In between these two extremes there are various combinations of systems which are adapted to the individual country and the policies of the leaders. All systems have features of private ownership, incentives, and government planning, but certainly there is a

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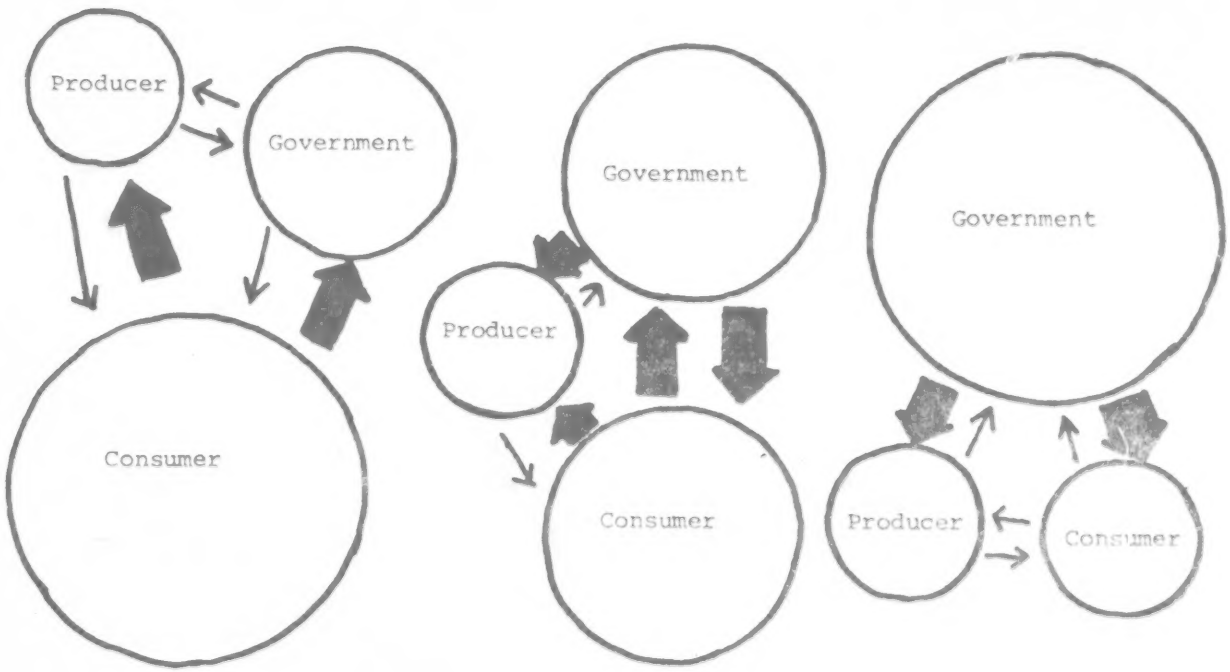
different emphasis on these features. The relative importance of government, producers and consumers in making economic decisions can be shown for the different systems as illustrated by the size of the circle and the directional arrows in the diagram shown below.

Since pure capitalism or pure communism do not exist anywhere, our study will probably be more meaningful if we consider existing systems. Let's use our country as an example of a capitalist oriented economy, France as a country that is using

ECONOMIC SYSTEMS



CAPITALISM MARKET SOCIALISM CENTRAL PLANNING

regulated capitalism, Yugoslavia where market socialism is encouraged, and Russia that claims to be oriented toward central planning.

Features of Our Capitalist-Oriented System

Like others, ours is a mixed economic system. We still have the chief elements of a capitalistic system of competition, private property, profit motive, and a reasonably effective market-oriented economy in which the pricing system guides production and consumption. The government does not dominate business. Businessmen are relatively free to pursue any course of action they wish. The government does influence the economy through taxation, government spending, and the banking system.

Businesses provide us with more goods and services than any other country can provide for their people. The remarkable progress we have made and the performance of our economy is evidence that our system has worked well for us. Most of us appreciate the opportunity to make our own decisions on where we will work, and how we will spend our money. Our ability to continue to grow will depend on how well all of us make decisions.

Our economy is flexible. We have adapted to changes in technological advances, war, and peace. We have been encouraged to come up with new ideas, new products, and new methods. We have benefited from the results of research and experimentation.

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The interests of the consumers have had high priority, but as businessmen, investors, and workers our interests have not been neglected. The claim that ours is a consumer and market-oriented society can be justified.

All these strengths are not without some claims of weaknesses. Some think our system does not allocate enough resources to welfare, education, and recreation and for this reason we need government planning. Even though we have made some progress, there is still economic inequality with a rather unequal distribution of income among various groups in our society. There are some that have "unearned incomes" and live on interest, dividends, gifts, and inheritances. They do not have to have regular jobs. Some would say this is not right when a system allows such a thing to happen.

Some businesses with control and influence on prices often try to use unreasonable and undesirable methods. Unless regulated by government, the interests of society are not served. On the other hand, with a freely competitive economy, there may be waste and duplication. When profits are high, businesses are attracted to the point that we get overproduction and failures of different organizations. This results in poor use of resources.

In our efforts to help other countries see the advantages of our system, maybe we have not thought of their problems from their point of view. To assume that the methods we use to be

so successful can be used by others may be challenged. Is our role as a promoter of private enterprise one to give to others or is it one to help others to help themselves? This is a problem confronting those who make policy decisions. It is essential in our relationship with a country such as France that now wants to go more on its own and has chosen, it has claimed, to combine the desirable features of both the market system and planned system.

France--Regulated Capitalism

France has a unique economic system that is considered by some to be oriented toward socialism but it is really more of a regulated capitalistic system. The French Government is involved in planning and regulating certain industries, but there is also a strong free enterprise sector in the system, as we shall see in our study of their attitude toward competition and monopoly, the government sector and their economic planning methods.

Attitude Toward Competition

Competition and free enterprise are thought of differently in France than in the United States. Private property and private ownership for them serve the same function as in capitalism. But the French do not idealize vigorous competition as it exists in America. The French believe that competitiveness must not intentionally destroy another man's business, and that the

survival of small firms are evidences of competition. The French demand for individualistic and custom-made products in preference to mass-production articles has encouraged small business, so most of the enterprises are small and family owned. Frenchmen treat competitors as neighbors and friends. They exchange orders and help each other to develop markets. Price competition does not exist. They compete more on the quality of the products they produce or the service they provide.

The free enterprise sector then is characterized by a blend of market competition and cooperation among rivals. Several writers have estimated that more than 80 percent of all output of French industries is presently produced by privately owned firms while agriculture and commerce are almost 100 percent privately owned.

Attitude Toward Monopoly

Monopolies are permitted in France in selected industries. It is claimed that they are interested in providing high quality products and good services rather than charging excessive prices when they can control the supply and the price. Trade associations are known as groups interested in control to prevent wasteful competition. These associations say they make decisions together in the interest of society.

The Government Sector

The leaders of France have nationalized industries that serve most of the people. These include banking, public utilities,

and natural resources. The government controls the gas, petroleum, coal, aircraft, railroad, water, travel, newspapers, electricity, metals other than iron, and the motion picture industries. Government ownership, however, amounts to only about 20 percent of the industrial capacity of France.

Economic Planning

Another aspect of the government influence in the economy involves economic planning. Representatives from different industries work with a few government planners to determine goals several years in advance. The plans are not detailed decisions on what to produce or the methods to be used, but rather overall agreed-upon objectives. They indicate what is desirable rather than what should be done.

With representatives of business, labor and other groups taking part in the planning, the French leaders have not exercised direct economic powers to enforce the plan. They have provided inducements in the form of tax considerations and aid in plant relocation. The French people have been left more on their own to make decisions except for government owned industries. Committees are organized and workshops are conducted by the original planning committees on local levels to put the plan into operation.

Government in France plays an advisory role in economic planning, but it also has an authoritarian role. Government has tried to control the swings of prosperity and recession by

different regulating on the private sector of tne economy. Government controls the expansion and growth of business by controlling building through building permits and bank borrowing. Government has legal stand-by laws to control wages and prices in inflationary or deflationary periods. Wage control involves minimum wages and other controls. Collective bargaining between unions and managers is controlled to a greater extent than in the United States. What might be called a nation-wide unemployment service distributes and moves the labor force where it is needed.

Government planning in France is far from being economic. Many aspects deal directly with social and cultural needs of the people. In order to provide economic security to its people, the French have set up in some degree a welfare state. Each individual is guaranteed a minimum standard of living that cannot be disturbed by unemployment, illness, or other economic disturbances that occur in the industrialized society he lives in. Social security and social insurance provide compulsory medical and old-age pensions. Bonuses are given to large families, programs are in operation to care for the aged, and education is a highly centralized system.

An Evaluation

The economy of France has shown substantial progress since 1959. The economy is still operated primarily by private enterprise, but it is state-directed and welfare-oriented. Planning has been successful. Businessmen take part in planning by pro-

viding ideas and then supporting the decisions. Government planners use their powers sparingly and only after great efforts to persuade businessmen to conform. Incentives to carry out the plan are given in the form of tax incentives and financial aid.

The French have income inequalities that are still large. Individual income taxes are less progressive than ours, but corporation taxes are higher. Consumers have fewer choices than people in the United States, but they are relatively free to make most decisions. Their social welfare systems provide old-age pensions, unemployment insurance, health service, social security, and allowances for children.

The leaders in France seem to have a keen sense of national loyalty. It appears that they have a desire to develop their own way of life. To some of us it may be difficult to correctly evaluate this attitude in view of past relationships between our two countries.

Yugoslavia - Market Socialism

Market socialism is referred to as the economic system that stresses government ownership and management of natural resources and produces goods used in large-scale production, but consumers and small producers are encouraged to make decisions. The main purpose of this system, it is claimed, is to more equally distribute the increasing national income without reducing

the part played by the people. The economic methods used in Yugoslavia seem to be oriented toward market socialism. It offers a unique example for study since the planners have tried to adopt what they claim to be the desirable features of different theoretical systems.

Politically Yugoslavia is communistic. The Communist League has widespread membership that dominates the "Socialist Alliance of Working People" which is the political party. The "League" controls the economic and social legislation as well as the party, but there is decentralization of decision making by enterprises in response to market forces instead of detailed planning and administrative orders in physical terms by the central authorities. Worker's Councils play a major role in enterprise management. Businesses attempt to maximize profits and consumers are permitted to make decisions freely.

Since 1948 when Yugoslavia made the break from Russia, the economy has operated independently of any major force. Their resources, both natural and human are limited. There are about 20 million people in Yugoslavia where about one-half of the population is still on small farms. Most of the peasants own their land. Collective farms were officially abandoned in 1953. The size of the farm unit is limited by law in most cases to about 25 acres of cultivated land. This discourages efficiency, but satisfies the independent family that is content to provide for its own needs.

Economic Planning

Up to 1953 centralized planning was emphasized to get a large investment in selected industries. Investment funds were allocated by planners. The buildings and equipment were to be owned by the State. A high level of taxation was used to supplement gifts and loans to obtain large amounts of money to develop a production base.

Once the facilities were developed, the planners decentralized the decision-making process. Worker's Councils were organized and members elected by the workers. The Council then selected a Managing Board to carry out the everyday decisions according to the policies of the group. The Council directed such things as wage setting policies, capital expansion programs and the distribution of profits. This system is still used in Yugoslavia. The transition toward a freer type of economy appears to be acceptable not only to the people as workers, but as consumers.

Wage and Price Policies

Wage rates are determined by the Workers Councils for their workers. They are based on the earnings of the enterprise, but must be attractive enough to keep the workers. Trade unions have no need to bargain for higher wages since the enterprise itself is managed by the workers. Unions concern themselves with fringe benefits and social problems.

Prices on the domestic market are freely determined by supply and demand. They are influenced by high tax rates, but consumers have the choice on how they will spend their money.

The variety and quality offered is very different from that of the United States. International trade, on the other hand, is controlled by the State.

An Evaluation

The Yugoslavian approach of trying to develop independent of other nations is dominated politically. Even with limited resources the rate of growth is about 4 percent per year. There are still the problems of a developing country. The limited size of the farms, the low fertility of the land, the slow process of investing in agriculture gives little hope toward greater efficiency in agriculture. If over half the people remain on the farm, limited progress can be expected toward an advanced economy. Many of the Yugoslavian people both on the farm and in the city still live in poverty according to our standards.

Improvements have been made in industry. The Worker's Council system seems to work well for the worker. More consumer goods are being made available. The price level has been stabilized during the past few years. The independent peasant seems more satisfied on his small farm rather than in large collectives. Programs are being used to improve roads. More money is being allocated to education, but by our standards, Yugoslavia has a long way to go. From their point of view it appears they are moving in the right direction and our standards, even if they know more about them, may not be to their interests.

Russia and Central Planning

A centrally planned economy uses government regulation for all phases of economic activity. We will use Russia as an example, but we must remember that there are some parts of their economy that are competitive, and they allow people to own some property.

State Ownership

The constitution of the U.S.S.R. (Article 6) states that "the land, its mineral wealth, waters, forests, mills, factories, mines, rail, water, and air transports, banks, communications, state farms, and municipal enterprises belong to the people." This state ownership means that the government has the major responsibility of deciding how the resources are used, how much is produced and what price is charged.

Rights of Individuals

Citizens are not permitted to own a profit-making enterprise or engage in any commercial activity except as approved by the State. The leaders in Russia have allowed producer cooperatives to be organized to manufacture toys and furniture, but these groups are supervised by the State banking system. Individual farmers are permitted to operate a small plot (½ to two acres) near where they live. They can use what is grown or sell it to others at whatever price they can get.

Consumers can purchase a car, radio, television, house, and other goods. These items are private property. They can be sold or passed on to their heirs. A limited amount of credit is used based on the guides established by the government. Individuals have limited investment opportunities. Government bonds can be purchased through the State bank. Interest over a period of years has been about 3 percent.

As a member of a collective farm, a person has ownership similar to our cooperatives. The amount of ownership is based on the work contributed over a period of years. This equity can be sold or transferred. The products left over or not needed on the farm after the State has purchased a previously determined amount, can be sold wherever the leaders of the collective desire. It is often sold in a nearby city at a public market where prices are not set by the government.

Consumers are relatively free to spend their incomes as they wish. The government does influence consumption by controlling prices. If there is a shortage, the price is raised and fewer people can buy. Prices are lowered if there is a surplus. These are arbitrary decisions of the planners and are not based on the market system of supply and demand.

Workers are relatively free to decide where they will work. Slave labor camps were done away with in the period 1954-56. A person can change jobs if he gives the manager two weeks notice. Planners do influence the jobs of those given special training.

Graduates from professional, technical, and vocational schools are assigned their first jobs. A young specialist can decline the first assignment but must accept the next one made by the planners. There is no negotiation as to rank or salary and the person must stay on the job for two to four years. Labor unions exist, but only to support the State. The Soviet worker does not have the right to strike, and wages are not subject to collective bargaining. Wage rates are determined by the government officials. The manager of a plant, however, can offer better housing or some fringe benefit to attract workers.

How Prices Are Determined

Planners decide on what price will be charged based on costs of production, a marketing expense, a planned profit, and a turnover tax similar to our sales tax. The turnover tax is charged at the manufacturer level, however, so the consumer is not aware of how much it adds to the price. If there is a shortage of a particular product, the turnover tax is raised and some consumers find the new price is not attractive to them. The reverse is true when there is a surplus. The Soviets claim this is far from an arbitrary pricing system, but they admit little consideration has been given to producing what consumers want until recently.

Influence of Government Planning

There are many estimates of the degree of government planning in Russia. It is clear that financial planning is 100 percent

since the State bank supervises all financial transactions. About 95 percent of the manufacturing and industry is directly controlled by planners. About two-thirds of the marketing facilities, and approximately the same proportion of the housing is owned by the government. This leaves one-third for private ownership. It is estimated that 35 percent of the acreage sown is in State farms. The balance is in collective farms except for the private plots of one-half to two acres which are allowed individual families. This is in contrast to 95 percent which was controlled by individuals up to 1928.

The influence of the State bank cannot be overemphasized. No selling agency has the power to grant a buying group credit. All funds must be kept in the State bank. While shipments are in transit, the invoices of bills of lading are cleared through the State bank. Supplies or working capital are made by budgeting appropriations and government allotments. Loans are usually made for a short term at 2 to 4 percent interest.

Since the government allocates the money, they can emphasize the development of any part of the economy. The goals have been oriented primarily to industrial and military developments rather than to the welfare of the consumers except for medical and educational services. Recently the leaders have emphasized that Russia has a productive base, so more money will be allocated to produce what consumers want.

An Evaluation

We can't evaluate the Soviet economy on the basis of a system we would like for ourselves or on the basis of Marxist ideas. In the first place it would be a negative evaluation since most of us want no part of a central planning system. Likewise, Marxian ideas are not evident in our economy and only to a limited extent in the economic decisions of Russia. Politically, however, Marxism is still accepted in Russia.

The leaders in Russia have proven that a planned economy can work. It has proved complicated and difficult, but the Soviets have grown and developed rather rapidly. Productive efficiency has increased. More responsibility has been given plant managers. Labor efficiency has been improved. Some of the progress has come from borrowed technology from the western countries, but the Soviets have made some developments of their own. The standard of living has been improved, but is still only about one-third that of ours. The medical services and educational programs are considered on par with those in our country.

Much of their progress has been in non-economic accomplishments. These are in the form of advances in the pure and applied sciences such as space and physics, a first-rate military power, modernization of the rural society, and better educated people.

There are problems too. Many of the goals have not been achieved. Cost accounting until recently has not been considered important and has delayed their progress. They do not have a

way to measure capital efficiency since they control interest rates. Agriculture has been slow to develop. The short growing season has been a problem in newly developed areas. Tensions in dealing with western countries have limited trade.

Many have speculated on the growth of the Soviet economy compared to our progress. Some suggest that they will out-produce us in a few years. Let's consider some of the possibilities.

The Great Economic Race - U.S. vs. U.S.S.R.

Even the most optimistic writers (Soviet and American) agree that the Gross National Product in Russia is about half that of the United States. The difference of opinion is in the rate of growth of the Soviet economy we can expect in the future, in comparison to our ability to increase GNP. If we grow at the same rate, they will never catch up to us, since our GNP is roughly double theirs. So the claim to catch us must be based on their ability to grow at a more rapid rate because they started at a lower base.

It is true that for most years from 1950 to 1963 the Soviets showed a growth percentage higher than ours. The growth rate gap which was so favorable to the Soviet increase has been reversed. During the past few years we have increased GNP at a more rapid rate. The planners in Russia claim this is a temporary situation, because of bad weather and some adjustments they

have made that will sacrifice short term gains in favor of long term growth.

Information is being published and made available to planners quickly so adjustments can be made without delay. With this information the available labor, use of equipment, power, and transportation can be better used, they claim. They can get efficiency in not only production but in the distribution of products. Planners prefer and claim they are able to make adjustments in output and supply rather than in price for they believe this method is simpler, cheaper and more certain to achieve the results they desire.

From our point of view, the market system is a more effective way except with public utilities and cases where a completely free market results in waste and duplication. We must not underestimate the Soviet economic challenge, but it may not be quite as serious as many in the west have supposed. The threat will be less if we can accelerate our growth rate.

PART V

PROBLEM AREAS AND THE FUTURE

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Chapter 15

ECONOMIC POLICY AND THE FUTURE

Many claim the Employment Act of 1946 is the foundation for a new approach to devise methods for solutions to some of our persistent economic problems. Congress passed this Act to authorize the President to use government powers to maintain maximum employment, production, and purchasing power in our economy.

A New Economic Policy

The policy of using government spending and taxing power together with power of the Federal Reserve Board of Governors to manage the supply and cost of money have had an important influence on our economy in the past few years. If consumers and businessmen show signs of slowing their rate of spending, the idea is for government to take up the slack. If the economy moves too fast, government should alter spending and money policies. Raising taxes, reducing government spending, raising the interest rate paid by banks, and if necessary, raising reserve requirements for banks will tend to slow down the economy.

In summary, the objectives of the new economic policy are full employment of resources, continued growth, price stability, and a balance of international payments with confidence in the dollar.

Many questions have been raised about the new economic policy. Can a government disregard the long accepted idea that to be financially strong it must live within its income? Can annual deficits and increases in national debt be a part of the economy without inflation? Can inflation be encouraged without serious risk of letting it get out of control? Will persistent deficit spending really provide enough stimulus to iron out the business cycle? Some will argue that when we consider these questions from a long run point of view, we may get a different picture than to form conclusions on temporary short run successes. For example, the tax policy that worked in 1964 did not work in 1968.

There are some side effects of the different approach that have been building up to the point where new problems are created. There are some that think there are risks involved in going too far and too fast with the new economic policy. The risks are an accumulation of debt, loss in the value of our dollar, and uncontrolled inflation. The penalty could mean recession and loss of our position of world leadership. Attitudes of people may change from the tradition of personal thrift, self-responsibility, and driving ambition to people depending more on government to solve their problems. The signs seem to suggest that there are more reasons for skepticism than seem to be generally recognized. It has been demonstrated

that by using government powers, we can get expansion going and keep it going for an extended period. What is not clear is whether we can do this without an inflationary boom which once started cannot be kept under control.

Some Persistent Problems

The United States is widely recognized as a wealthy country. Our resource base is reasonably good. A large proportion of our workers are skilled and productive. We are considered well educated with efficient management, well-trained scientists and competent professional people.

Much of this image is true. In material things we are better off than the people in any other country. But with all our wealth, there is poverty among people living in a prosperous country. There are many families that live in inadequate housing and do not have enough income to buy the necessities of food and clothing. There are shortages of some of the resources. There are inequities in the distribution of income.

We live by comparison. When others have more than we do, we are angry. If some appear to be favored over others because of the color of their skin or the place they live, we are discontented. Being poor is not a choice in many cases. It is handed down from generation to generation.

A spirit of defeatism often prevails and the desire to get ahead is lacking.

There are groups too in our society that because of the nature of their industry receive rather wide price variations for the products they produce. One such example is agriculture. Periodically the steel industry has had to make major adjustments. The automobile industry often has to cut back on production, which results in temporary unemployment and poor use of resources. Most groups have to make continuous adjustments, but some have more problems than others. In this discussion, consideration will be given to a few of our economic problems such as poverty, adjustments in agriculture, food supply and population growth, inflation, pollution, and the energy crisis.

Poverty

In the great depression of the 1930's the government launched a relief program to help people until they could get back to work. Since then we have had many programs to help the poor, many of whom have been on relief for several years. Relief rolls continue to increase in the midst of prosperity. The poverty stricken are concentrated more in certain areas, but they can be found in all states. They include rather definite groups of underprivileged children and families, the chronically unemployed, and the older people.

The underprivileged children come mostly from families where there are limited opportunities, lack of motivation, guidance or encouragement given them to be a producer in society. They may be from fatherless families due to death, desertion or disability. By the time the children reach the age to find a job, they have little or no training to fit into a skilled labor force.

The chronically unemployed who are capable of working but lack the skill, ability or education to qualify them for jobs in a specialized society create a serious problem. They are not a part of society that shares the prosperity resulting from technical advances in business and industry. They need to be trained to be producers. A nation is only as productive as its workers. If the unemployed can find work, it means a stimulus to the economy and at the same time a reduction in the amount spent for public assistance programs. These are programs sponsored under the Economic Opportunity Act passed by Congress on August 20, 1964. The purpose of the Act was ". . . to eliminate poverty in the midst of plenty in this nation by opening to to everyone the opportunity to work and the opportunity to live in decency and dignity." The new law provided for youth programs, community action programs for rural areas and work experience programs.

There are some among the older people who have lived in poverty all their lives. Others are on limited retirement income

which has reduced purchasing power because of inflation. The private enterprise system is not designed to care for people that live in poverty. As a result, welfare and government agencies bear the primary responsibility of caring for the poor. Public assistance and various rehabilitation programs are formed in all states. Many of these programs have been successful in helping individuals become productive within our economic system.

Adjustments In Agriculture

Just a few years ago, prominent agricultural experts cited examples to prove that United States farmers could produce far more than could be used to a good advantage in our economy. They advocated the tightening of government controls over production and the marketing of food and other farm products. In recent years the ideas presented are that with the world population increases, the markets for U.S. farm products are unlimited. These ideas are related to the farm problem and the possible solutions.

Our farmers, like our workers in industry, have been affected by technology and automation. The farmers who have enough land, capital, and education have been able to reach high levels of farm income. But the small farmer who has not been able to expand or obtain additional work because of lack of employment opportunities off the farm has been forced to a low level of economic existence. The distressed situation on low income farms is

caused by low productivity. It is due largely to the fact that these farmers are working with inadequate amounts of land, equipment, livestock, technical information, and managerial ability. More economically-sized farms, improved practices and better selection of crops and livestock would improve the situation.

Immobility in agriculture creates a problem. A farmer hesitates to change his occupation because farming is not only a vocation but a way of life. He is a farmer largely because he wants to be one. This is the work he knows how to do. He prefers the outdoor life and being his own boss. His ties are in the rural community. His friends and his children's friends live nearby. He often is not sufficiently aware of the variety of opportunities in the city, but he does know that during a depression when the prices of his products are lowest, there is much unemployment in the city. At such times he finds security in the fact that he can at least eat the products of his garden and livestock.

The nature of farm production is such that it is difficult to make quick adjustments. Once a crop is planted, a substantial part of its total cost has been incurred. Even with a price drop, the farmer is likely to carry it through to the harvest. It requires years to produce cattle for beefsteak. Orchards for the production of peaches and apples

take even longer. It takes time and a substantial investment to build up dairy herds and equip a dairy farm.

The role of nature is also very important. Variations in total output are far from being under strict human control. Good weather, moisture and pests are important. Conditions in other parts of the country or even in the world with some agricultural products may have an influence on local farm prices.

Because of the instability of farm prices, the government has assumed a role in agriculture that many have questioned. Production controls, marketing quotas, soil bank and price supports have not solved the problem. High price supports not only fail to help make the adjustments, but actually encourage greater production. This is particularly true when prices are supported on an individual commodity basis. We not only prevent the necessary adjustments in supply, but we reduce demand by the resulting higher consumer prices.

Another criticism of the existing agricultural program is that it benefits least those farmers who need it most while it has presented outright gifts to farmers who need it least. The large farmer naturally gets the most gain from price supports because he produces more bushels, bales or tons, as the case may be. The program, therefore, cannot be defended as an effective way of helping low income farmers to attain a minimum level of living.

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Other criticisms are made of the government's participation on the basis of inflated land prices resulting from price supports, encouraging the inefficient, the inequities of the products that are and are not covered, and the expense of the program. The opportunities for waste and favoritism become greater as we move from free markets. Many of the possible solutions to our farm problems are designed to return to the working of the market system. Farmers' response to increasing production and helping to solve shortages in the past has been rather quick where the market system has been permitted to operate.

Food Supply and Population Growth

Throughout history we have been concerned with the relationship of our ability to produce food and the number of people. It is argued that population usually increases faster than our ability to produce food. Even in our country some are fearful that in a few decades it may become difficult to provide enough food to sustain our population with an adequate diet. One estimate was made that our population by 1975 would be 193 million people and to provide food 470 million acres of cropland would be required. Were consumption raised to what the Bureau of Human Nutrition and Home Economics defines as an adequate diet, about another 70 million acres

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of cropland would be needed.[1]

Already we have exceeded the 193 million mark and our food supply has been increased to the point that we have been able to help other nations. But still in the world today, it is estimated that half the people are underfed. In our own country millions are not properly nourished.

Population trends have been given more attention in the last 20 years than at any time since Thomas Malthus first published his essays on population in 1798. It is pointed out that it took the world thousands of years to 1850 to reach one billion people. It took 80 years (1850-1930) to reach two billion and only 30 years from 1930 to 1960 for the world population to get to three billion people. By 1975 or 15 years from 1960, the world population will be four billion.[2]

According to United Nations estimates, world population is growing by 8,000 per hour or approximately 70 million a year. This number is equal to the populations of France, Belgium, and Holland taken together. Medical discoveries and widespread advances in sanitation have improved health and lowered death rates. Various population control methods

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[1]Johnson and Barlowe, Land Problems and Policies (McGraw-Hill, 1954), pp. 220-221.

[2]U.S. News & World Report, September 16, 1963.

have been suggested, particularly for the overpopulated areas. Some see too many people for the resources that are available. The acreage of cultivated land and the yield per acre can be increased, if we use known technology. This requires education, capital, and management which are not widely available in the over populated countries.

In our country we do not view the problem with as much alarm. Our population has increased faster than the forecasters anticipated, but the rate of increase has slowed down in the past few years. Our production has increased even faster than the population, so we look at the Malthusian idea as something that does not apply to us. Farm technology has increased to the point where about 5 percent of the population can provide the food and fiber we need. We must, however, continue to invent, improve, and adapt new methods. All of these seem possible in our country.

Inflation

A general analysis of inflation was made in Chapters 11 and 12, but because of the severe impact it has had on individuals and the world economy, a more detailed explanation may help us to understand the significance of the problem. Inflation results when the supply of goods and services does not increase as fast as the supply of money and the demand for what we buy. We measure the effects in a general way with

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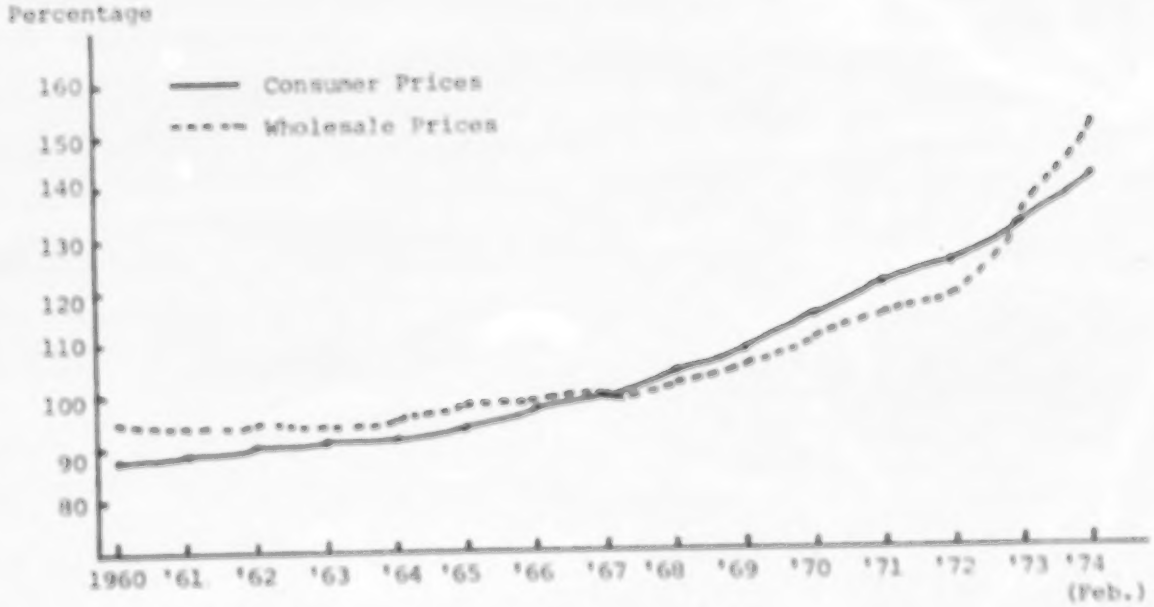
indexes of consumer and wholesale prices. To make comparisons, data are now referenced to a base year of 1967=100.

During the early 1960's prices gradually moved upward. These changes were considered reasonable since the growth pattern was relatively favorable. The real problem developed in the late 1960's and became severe in the early 1970's. As has already been pointed out, price controls did not solve the problem, but price increases were even larger as we moved through the four phases of controls.

The magnitude of price changes can be shown in comparing wholesale and consumer prices since 1960.

CONSUMER AND WHOLESALE PRICE INDEXES



Source: Federal Reserve Bulletin, Division of Administrative Services, Board of Governors of the Federal Reserve System.

Some satisfaction can be gained in knowing that inflation in the United States has been less than in most other countries. Even including the recent rapid inflation of 1972-1974, the average increase in both consumer and wholesale prices has been about 4 percent per year from 1940 to 1974. In some countries the increase has been nearly 100 percent a year in selected periods.

As inflation continues to be a problem, we should plan our decisions accordingly. Experience shows there is no sure way to avoid the effects of increases in prices, but there are some points to keep in mind when planning for the future.

1. Importance of a secure job to take advantage of merit increases in salary.
2. Owning a home, land, and other property.
3. Plan an organized investment program.
4. Invest in companies and businesses that have a proven record of earnings.

Pollution

The increasing concern for the amount and use of our resources is justified and many would agree, is overdone. Questions arise as to who should take the responsibility for an organized program and which groups should bear the costs. Private enterprise, motivated by the profit motive, has a tendency to go slow in adopting conservation and pollution control programs. Government groups have hesitated to get involved. Consumer groups in general have not been organized.

Special interest groups have been oriented to a stronger position than has been reasonably acceptable to systematically solving the problems.

Pollution involves water, air, solid-waste, parklands and public recreation, and noise management and controls. The environmental problems are deep-rooted and widespread. It is claimed that improving on surroundings is everyone's responsibility. A Council on Environmental Quality and a Cabinet Committee on the environment have been established on a federal level. Industry has recognized more of its own environmental responsibilities and has made substantial progress in many areas. Educational groups have supported a teaching and action program. Leaders in communities and some citizen groups have encouraged a positive approach to helping solve the problem.

Unfortunately some special interest groups have gone so far as to hinder growth based on incomplete information, prejudiced opinions, and desire for recognition. Some industries have had to be forced to adopt reasonable improvement practices and others have been in a difficult position to meet the requirements imposed upon them.

Although many have been interested in specific pollution problems, probably the most comprehensive program has been the one suggested by the President to Congress in 1970.

The main provisions were:[1]

For Cleaner Water--

Authorize 4 billion dollars in federal money to match 6 billion dollars in State and local funds for sewage-treatment plants in next four years.

Set up an Environmental Financing Authority to help finance waste-treating plants.

Revise laws to build plants where most needed.

Require waste-treating plants, and their operators, to meet minimum standards of design, operation.

Get cities to collect users' fees from industries to pay costs of treating industrial wastes.

Require comprehensive river-basin plans, so waste treatment is backed up by other actions.

Encourage large-scale regional treatment facilities.

Extend federal-state water-quality standards to effluent from all industrial and public sources.

Make water-quality violations illegal.

Revise federal rules to get faster court action against those who violate water standards.

Allow fines up to $10,000 a day for water violations.

Authorize the Secretary of Interior to seek immediate injunctions where water pollution threatens health or irreversible injury to environment.

Extend federal pollution controls to all inter and intra-state waters, above and below ground.

Triple federal grants to state pollution agencies, from 10 million dollars a year to 30 million dollars by 1975.

For Pure Air--

Establish tighter auto-exhaust standards.

Tighten enforcement of new-car antipollution rules.

Authorize Secretary of Health, Education and Welfare to regulate gasoline and additives.

Start research to produce a low-pollution auto, using "unconventional" power, in five years.

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[1] U.S. News & World Report, February 23, 1970.

Begin tests to aid private developers of new-type cars.

Set national air-quality standards, to be met by States.

Speed up mapping of air-quality-control regions.

Establish national standards for harmful pollutants.

Extend federal air-pollution controls to both interstate and intrastate situations.

Allow fines up to $10,000 a day for violations of air quality and pollutant-emissions standards.

For Trash-and-Waste Disposal--

Focus research on techniques for reusing materials and producing materials that will decompose easily after use.

Pay bounties for scrapping junked cars.

Develop other incentives to speed trash disposal.

Establish a National Industrial Pollution Control Council, to encourage environment programs.

Give priority to patents for devices aimed at curbing environmental abuses.

For More Parks--

Make 327 million available to Land and Water Conservation Fund for park-recreation areas.

Look over federal property for places that can be used, or sold, for public-recreation purposes.

Relocate federal installations in locations needed for other purposes, including recreation.

Extend the Land and Water Conservation Fund, to be a source of money for future land purchases.

Let Interior Department sell land to State and local governments at discounts up to 100 percent.

Change accounting rules to encourage federal agencies to use property more efficiently or sell it.

Help States and local governments use idle farms for recreation.

Make long-term contracts with owners of idle farms for reforestation and other improvements.

Energy Crisis

Most of us were not aware of the seriousness of the energy crisis until it started directly affecting us. Actually, the problem has been developing for many years. With our abundant resources, and the unlimited wants of people, the pressures were to be more concerned with the present than the long time future needs. In addition to inefficient use of our resources, we emphasized the automobile, a subsidized road system, spreading out into the suburbs, and federal regulations that have not encouraged development of coal, gas, and oil in our own country. Environmental regulations have increased gasoline consumption, delayed the construction of oil pipelines, reduced the mining of coal, and slowed down the development of atomic plants.

There have been a large number of suggestions and proposed programs to help solve the energy crisis. Doing away with price controls and a return of a more market oriented pricing system would serve as a rationing device. Voluntary reduction in the use of gasoline, electricity, and oil would make us less dependent upon foreign suppliers. Traveling at lower speeds reduces gasoline consumption and accident rates. Financial support to resource development companies, either in the form of a direct subsidy or tax considerations, would encourage future developments and make us more self-sufficient. Recycling and using what are now waste products through the basic

industrial processes would make it possible to reclaim our resources and help solve some of the disposal problems.

Current energy shortages confront government leaders and the general public with rather specific alternatives. We will either learn to conserve our valuable energy resources and adjust our economic goals to reality or we will be faced with disruption of our economic growth and unemployment of our workers. Commitments to the development of additional resources of energy will reduce the uncertainties of inadequate supplies. Fortunately, our technical know-how for development and our ability to finance projects should not be constrained. The magnitude of the energy crisis has been indentified in various studies of selected industries. Research is now in process or being proposed to evaluate the impact of different alternatives. Reports are being published that that will give directions to help us adjust to our constantly changing economic system.

Our Economy in the Future

There are problems in our society and we have reason to be concerned, but most people look to the future with a great deal of anticipation. We do not expect our economy to function perfectly. We know there will be constant adjustments, but what will our economic system be like in 10 years, 25 years,

or even a longer period? It is interesting to speculate about some of the possibilities.

As the economy matures, an expanding partnership between government and business appears to be a possibility. Programs of training workers, slum clearance and cooperative research could be mutually beneficial. Local-federal government relationships are likely to increase since the tax structure that emphasizes income will channel funds through the federal government rather than through income from property taxes at the local level. Revenue sharing will be important under these conditions. Small city governments may find it an advantage to consolidate to get greater economies in planning the use of these resources.

Some specific developments we can expect are the use of the ocean to provide an increasing amount of food, commuter planes and trains to speed suburbanites between their homes and their jobs in the city, a system of canals and rivers to distribute water from Alaska to Mexico through Canada and the United States, fresh water from the sea through the desalting process and the development of model cities.

Other rather general developments we might anticipate are more automation and the use of computers, improved technology, development of new markets, changes in the products we use, increased recognition of the contribution of research and

increased local, state, and federal regulations. If we put all these together, it would appear that our success will depend on our ability to fully employ our resources. We must remember, however, that the market system usually does not allocate enough resources to education, city planning, recreation and other programs of public interest. As the economy matures we can expect a large proportion of our national income to go through public channels. This need not mean government ownership and control, but merely evidence of a growing economy.

These are only a few of the possibilities we can visualize at this time, but when we think of the progress we have made and try to project it into the future, it is a challenge to everyone. If we take an optimistic viewpoint, and assume our economy will develop rapidly, then the big test will be whether it can succeed where the problem is not economic lag, but economic excess.

Our Opportunities in Economic Decisions

As workers we are interested in an income to provide for our wants. As an owner of business, the success of the company is important. Labor leaders are concerned with the goals established for their organizations. We do have many interests in common. Among our cherished freedoms, we want freedom from hunger, limited unemployment, and protection from loss of income. With

few exceptions we are willing to work, assume family responsibilities, do our part in the community to make a contribution to society. In doing these things we take part in the decisions of our country.

In our everyday activities as consumers, we help make decisions on what and how much is produced by the way we spend our incomes. Our attitudes and aspirations are important to economic growth. We are aware that there are trouble spots in certain areas where people do not have regular jobs. It may be lack of an opportunity to develop a skill or of preparation for the changes that have taken place. Researchers tell us that if we invest in ourselves in various educational opportunities, we can expect a high return on our investment. The impact of economic education can be for personal well being, in the market place, in the voting booth, at places we work, and the influence on society as a whole.

In 1976 we will have our 200th anniversary. Young adults (the big spenders) represent a fast growing group. The part of the population between the ages of 20 and 34 will be higher by 1980 while other age groups will show slower changes. About two-thirds of the population in the next decade will be among the young adults--a group with rising incomes that is starting families and borrowing and spending freely. The economic education training many of these young people have received or will receive should result in large dividends to individuals as well as to society.

One of the best ways to get an appreciation of our own economy is to study other economic systems. It will help us realize the part every citizen plays in contributing to the success of our capitalist-oriented system in comparison to planned economies. On any economic basis we may chose, equity, productivity, security or stability, we find that our economy compares favorably with any other system and our future development depends on the part played by each person in our society.